TEGE Exempt Organization Council

Comments in Response to REG-106864-18

Unrelated Business Taxable Income Separately Computed for Each Trade or Business

June 23, 2020

This document responds to the request for comments in REG-106864-18, Unrelated Business Taxable Income Separately Computed for Each Trade or Business (the "Proposed Regulations"), and reflects feedback from individuals participating in the TEGE Exempt Organizations Council (the "Council" or "TEGE Council").

The TEGE Council was formed to (i) open and maintain lines of communication between the Tax Exempt & Government Entities Division (the "Division") of the IRS and the practitioner community, (ii) provide the Division with the thinking of the practitioner community on procedural and systemic matters, (iii) provide practitioners a forum to share their concerns with the IRS regarding both policies and specific tax issues and procedures, and (iv) educate the practitioner community and the exempt organizations community.

The Council's members and participants include attorneys, certified public accountants, and other practitioners and professionals in the exempt organizations community (including in-house practitioners and professionals). The comments below do not necessarily represent the views of the Internal Revenue Service (the "Service" or "IRS"), Treasury Department ("Treasury"), the TEGE Council, or any particular Council member. The preparers of these comments were not engaged by any client for the purpose of submitting these comments or otherwise to influence the development or outcome of regulatory guidance.

The Proposed Regulations request comments regarding:

1. Whether another method, or additional methods, of identifying an exempt organization's separate unrelated trades or businesses better achieves the intent of Congress in enacting section 512(a)(6) while still being administrable for exempt organizations and the IRS;

2. Whether there are other circumstances in which an exempt organization should be permitted to change NAICS 2-digit codes;

3. Examples of state taxes that are not directly connected with any separate unrelated trade or business;

4. Whether any other allocation methods should be considered unreasonable and the methods or rules that could be adopted instead of a reasonableness standard for allocations both between related and unrelated activities and between two or more separate unrelated trades or businesses;

5. The specific factors that should be considered when determining whether an activity is an investment activity for purposes of section 512(a)(6);

6. Whether certain permitted rights or actions should be disregarded in determining whether a partnership interest is a qualifying partnership interest;
7. The administrability of permitting the aggregation of indirectly held partnership interests that meet the requirements of the de minimis test;
8. Whether the rights or powers listed in the proposed regulations should be weighted the same or whether there are certain circumstances in which such right or power would never indicate control;
9. Whether permitting a higher percentage interest under the de minimis or control test in taxable years in which the increase occurs as the result of the actions of other partners would address concerns;
10. Whether any additional transitional relief is necessary;
11. Effects on ESOPS holding S corporation interests;
12. Any unintended consequences, in areas other than the unrelated business income tax, resulting from the treatment of investment activity as an unrelated trade or business for purposes of section 512(a)(6) for VEBAs and SUBs;
13. The particular facts and circumstances that should be considered by a social club when determining whether a non-recurring event should be treated as a separate unrelated trade or business, part of a larger trade or business, or as part of a social club's investment activities for purposes of section 512(a)(6);
14. How the special rule in section 170(d)(1)(B) operates when an exempt organization has NOL carry overs in more than one unrelated trade or business; and
15. The application of section 512(a)(6) to the public support test.

We address many of these specific requests and other key aspects of the Proposed Regulations in these comments.

Executive Summary

This section provides an outline of our recommendations, each of which is further explained below.

1. Taxpayers should be allowed to identify separate trades or businesses based on all applicable facts and circumstances, consistent with the other aspects of tax-exempt organization tax law. The NAICS codes should operate as a safe harbor for purposes of identifying separate trades or businesses.
2. Taxpayers should be permitted to change the identification of a trade or business (i.e. change the NAICS code assigned to its "silo") within the first two years of operating a new trade or business regardless of the presence of any mistake in identifying the most appropriate NAICS code. There should be additional flexibility in revising the use of

NAICS codes that, due to further experience with the rules and accounting for the activities, become better defined over time.

3. Investment activity is not an unrelated trade or business and should not be treated as an unrelated trade or business subject to 512(a)(6).

4. If the IRS and Treasury treat investment activity as an unrelated trade or business, then we recommend the following to make the regulations more administrable and less burdensome:

    a. Jettison the de minimis and control tests outlined in the proposed regulations for purposes of determining when a partnership is an investment or an operating business and use applicable accounting standards instead.

    b. ERISA-covered trusts should be permitted to aggregate all unrelated trade or business activities together, including UBTI arising from a partnership, because ERISA oversight rules ensure that such plans do not engage in a trade or business through partnership activity.

    c. Investments managed by registered investment advisors should be treated as qualifying investment activities that may be aggregated together.

5. To the extent the above recommendations are not implemented (i.e., if the IRS and Treasury treat investment activity as an unrelated trade or business and retain the de minimis and control tests), then we recommend the following:

    a. Tests for determining qualifying partnership interests should be based on actual control (as defined under applicable accounting standards), not mere ownership.

    b. The look-through rule—if used—should apply more broadly.

    c. Supporting organization ownership of partnership interests should not be taken into account in determining ownership or control for purposes of the control test.

    d. The transition rule should be expanded so that it covers any investment that does not meet the qualifying partnership interest tests, and so that it does not sunset.

    e. A reasonable-efforts standard should be adopted that allows an exempt organization to rely on information provided by a partnership in determining its qualifying partnership interests in, and sources of UBTI from, that partnership.

6. All non-member activity of a social club should be treated as a single "trade or business" for purposes of applying Section 512(a)(6).

7. All income created by statutory provisions should be treated as a single "trade or business" for purposes of applying Section 512(a)(6).

8. An organization should be permitted to treat all S corporation interests as investment activities, regardless of the organization's ownership percentage in the S corporation.

a. Alternatively, the term "qualifying S corporation interest" should be revised to include:

    1. any S corporation interest the organization acquired other than by purchase, regardless of ownership percentage, or

    2. any S corporation interest the organization acquired other than by purchase, regardless of ownership percentage, that is disposed of within five years of receipt (and that an extension for a second five-year divesture period be permitted in certain cases).

b. If the recommendations above are not adopted, matters related to the tax treatment of S corporation interests should be reserved for future guidance.

9. Clarify that the unadjusted gross-to-gross method is reasonable if there are no pricing differences.

10. Establish safe-harbor allocation methods for expenses.

11. Tax preparation fees, state taxes, and investment management fees should be deductible without the requirement to allocate among multiple trades or businesses.

12. Allow exempt organization to allocate pre-2018 net operating losses (NOLs) among separate trades or businesses in such a manner as to maximize utilization of the NOLs in the current tax year.

13. An organization should have the option to calculate the impact of UBTI on its public support either with or without regard to the 512(a)(6) rules, whichever is more favorable and/or least administratively burdensome.

I. Identifying Separate Unrelated Trades or Businesses

Section 512(a)(6) provides special rules for calculating unrelated business taxable income ("UBTI") for any exempt organization that "has more than one unrelated trade or business." Section 512(a)(6) further provides that such organizations compute UBTI separately with respect to each such trade or business, which is commonly referred to by practitioners and the exempt organization sector as "siloing." Although there is no overarching code-based definition of "trade or business," existing Section 1.513-1(b) of the current Treasury regulations reference Sec. 162 for the purpose of defining a "trade or business." The Proposed Regulations provide that use of the first two digits of the NAICS codes shall be the only method used to identify separate unrelated trades and businesses for purposes of Section 512(a)(6).

We understand that the Treasury Department and IRS believe this two digit NAICS method is the most administrable means of identifying separate trades or businesses for both the Service and exempt organizations. As the preamble to the Proposed Regulations notes, most commenters did support using the NAICS codes, and the TEGE Council was among commenters that supported its use in some way. We continue to support the use of two-digit codes as a safe harbor, but we recommend a test based on the weighing of facts and circumstances consistent with the other aspects of exempt organization tax law.

We suggested both a more general standard and a safe harbor (including NAICS codes) in comments to Notice 2018-67 dated January 14, 2019 (Exhibit 1). The Council proposed (and we reassert) that the NAICS codes should not be the only method available, as it is not practical for multiple unrelated business activities; rather, the codes should operate as a safe harbor.

Notwithstanding that we generally support using the NAICS codes as a safe harbor, we do have concerns shared among commentators that Treasury and the IRS lack the ability to revise the NAICS codes. As such, it is conceivable that the Economic Classification Policy Committee (ECPC) could modify the NAICS codes, thereby in effect modifying tax regulations periodically. While we are generally willing to take that risk when using the NAICS system as basis for a safe harbor, it seems imprudent to place that type of outside discretion on a third party entity not under the auspices of the IRS. We are also concerned that such variability in identifying separate trades or businesses arising from the NAICS system could have unintended other income tax consequences that Congress did not intend when enacting Section 512(a)(6).

Furthermore, the economic basis of the NAICS system is to group trades or businesses using a "production-oriented, or supply-based, conceptual framework" which result in troubling irregularities with how these codes are applied in the context of Section 512(a)(6) that Congress did not invite or intend.[1] The NAICS Code system is designed to group together similar production processes, rather than similar consumer products or services.

Irregularities arise from the fact that NAICS codes disaggregate activities that would otherwise be considered part of the same unrelated trade or business in pre-existing exempt organization guidance or under an analysis of all the relevant facts and circumstances. For example, if an

[1] See History of the NAICS Code, NAICS Association, https://www.naics.com/history-naics-code/.

organization conducted a sports tournament that displayed advertisements from a game sponsor in the arena where the tournament is conducted and also printed the same advertisement in its brochures for the event, all of the advertisements would reach the same audience—attendees of the event—but they would do so by different means. Thus, these advertisements may be considered separate trades or businesses, or silos, under the NAICS code system: event advertising as activity code 71 (Arts, Entertainment, and Recreation), periodical advertisements as code 51. For additional examples of activities that may be incorrectly designated as separate trades or business under the NAICS Codes, see our further examples below.

The Council's comments to Notice 2018-67 provided relevant factors for determining whether activities are separate trades or businesses for purposes of 512(a)(6). Those facts and circumstances may include evaluating the following:

- Causal connection to UBTI—i.e., the degree to which the activity contributes importantly to the generation of the revenue or loss. Would the revenue or loss have occurred but for the activity?
- Management structure—i.e., the extent of common control over the activity by the same persons pursuant to the same policies and procedures;
- Geographic location where activities are carried out; and
- Interdependencies between or among the activities, for example, the extent to which the activities:
    - involve the same products or services,
    - involve products or services that are customarily provided together,
    - are provided to the same customers,
    - are conducted by the same individuals,
    - involve common planning and coordination, or
    - are treated as a single unit or category for accounting and reporting purposes.

In articulating these factors, the TEGE Council members drew from analogous IRC sections (e.g., 183, 469) and related regulations setting forth factors taxpayers should use in grouping similar activities as a single trade or business activity, for purposes of those sections. When Congress recently enacted Section 199A, the resulting regulations addressed similar trade or business classification issues through a separate facts and circumstances test. The IRC has numerous instances of weighing facts to determine difficult questions among a wide range of different taxpayers with unique facts. We believe these regulations are no different.

One of the fundamental principles of taxing unrelated business income is to prevent unfair competition with for-profit businesses of the same type of revenue streams. By using the existing standards applicable to for-profit entities, the siloing determinations must be based on consistent

law and allow for exempt organizations and for-profit businesses to be treated consistently. Otherwise, exempt organization unrelated activities are unfavorably divided as compared to those of their for-profit competitors. We recommend a facts-and-circumstances test to alleviate the risk that NAICS codes might create multiple silos within what should reasonably be considered one trade or business, as our examples demonstrate.

In addition, within the proposed regulations the IRS noted that the use of a 2-digit code versus a 6-digit code would reduce administrative burden. While this may be true in theory, in practice, by eliminating a reasonable method determination, administrative burden remains an issue. The following examples demonstrate how the use of the 2-digit NAICS codes contributes both to administrative burden and inconsistent treatment between exempt organizations and for-profit businesses.

Example 1

A museum provides catering services, valet parking and personal property rentals for its special events clients as a package deal, which include wedding parties, area businesses, etc. The museum has a special events manager who manages and oversees the special events. The special events manager coordinates staffing needs for the special events with internal departments as well as external vendors.

If required to use the 2-digit NAICS codes, the museum could need to use up to three different NAICS codes to report the income as income from three trades or businesses: catering, parking, and rentals. The museum would also have to unbundle all the package offerings to segregate income from each event; and would have to allocate personnel costs, depreciation, utilities, and other expenses against the bundled activities.

In contrast, if the Museum were allowed to follow a more flexible standard, then the museum might be able to treat special event business as a single trade or business based on a reasonable and common sense understanding of the service provided (an event), rather than its various means of production. The museum might consider other factors such as the interdependence and the common control of the activity by the same persons in determining that the special events activity is one trade or business. In this situation, it would be less of an administrative burden on the museum to track revenue and expenses from the special events activity as one trade or business, rather than having to treat the special events activity as three different trades or businesses for Form 990-T reporting purposes.

This would put the museum in an equivalent position for tax reporting purposes as its neighboring for-profit conference center that also provides the same bundled services to wedding parties and area businesses. Moreover, the museum would still not be able to offset losses from its special events activities against other income from other unrelated trades or businesses, such as retail income.

Example 2

A college operates a hotel for additional income. The hotel provides not only room rental, but also cleaning services that are primarily for the convenience of the occupant. If required to use the 2-digit NAICS codes, the college may need to use two different codes to report the income from the room rental, even though the room fee would be excluded from UBTI if it were not for the cleaning services. Identifying a separate value for the cleaning services (code 56) would cause additional administrative burden for the college. Hotel room rental without services is otherwise treated in exempt organizations guidance as "rental income," which would suggest classification as real estate rental and leasing (code 53). However, there is an accommodation and food services code (code 71) that appears to allow the hotel operations to be grouped together, which undermines the use of the rental NAICS code for exempt organizations. Based on facts and circumstances, the hotel revenues should be grouped as one trade or business. Therefore, the calculation of taxable income is aligned with how other for-profit competing hotels are reporting revenues for tax purposes from hotel operations.

Example 3

A hospital provides certain health-care services to non-patients, including laboratory testing and prescription filling. These services are considered an unrelated trade or business under existing guidance because they are provided to non-patients. If required to use the 2-digit NAICS codes, the hospital may need to use two different codes (code 62 and code 44) to report the income from services delivered to non-patients. This example illustrates the limitations of using the NAICS system, which is focused on the production process, rather than on the consumer. Instead, the classification of separate trades or businesses should reflect the underlying reason for determining unrelated business income treatment. The common denominator is the provision of health care services to non-patients. Therefore, both the pharmacy and laboratory income should be treated as part of the same unrelated trade or business.

In addition to the issues described above, using NAICS codes as the exclusive method of identifying separate trades or businesses further tips for-profit businesses into an unfair competitive advantage against exempt organizations. At the baseline level, the NAICS codes disaggregate activities that are traditionally conducted together and computed together in a typical for-profit business. This effect is amplified when considering the impact of loss activities. By breaking down a single trade or business into component parts based on NAICS codes, it is more likely that certain of those components may generate more net losses than others. The first effect is to separate losses from gains that would be netted together if conducted by a for-profit business. The second effect is to dismiss the loss activity as not qualifying as an unrelated trade of business, even though all other factors deem the activity (composed of more than one NAICS code) to be an unrelated trade or business activity.

II. Ability to Change NAICS Code Classification

The Proposed Regulations require that once an exempt organization has identified a separate unrelated trade or business using a particular NAICS 2-digit code, the organization may not change the NAICS 2-digit code chosen unless it is due to an unintentional error and it can demonstrate that another NAICS 2-digit code more accurately describes the trade or business.

The Proposed Regulations did not prescribe a method to correct "errors." That process was noted that it will be included in the Form 990-T instructions, which will not be available before these comments are due.

There is a strong likelihood of erroneous codes being used due to the significant variability in the sophistication of both the reporting exempt organization and the legal/preparer community. Furthermore, there is a strong likelihood that there may be multiple appropriate NAICS codes for a given activity, and the view of which code best describes an activity may shift over time.

In light of these concerns, there should be additional flexibility in revising the use of codes that, due to further experience with the rules and accounting for the activities, become better-defined over time.

Our comments regarding the need to allow taxpayers to identify separate trades or business based on the facts and circumstances should prevent this issue from arising. To the extent that suggestion is not adopted, we suggest the use of a transition rule for the selection of a NAICS code. As with the general principles for establishment of an accounting method, a NAICS code should not be established until it has been used for at least two years.

The proposed regulations did not address whether a reconciliation is required for the prior years in which an incorrect code was used and, if a reconciliation is required, how any adjustment will be applied. More guidance is required in order to properly evaluate the impact of a change.

III. Investment Activity Should Not Be Treated as a Trade or Business

In the Proposed Regulations, the IRS and Treasury acknowledge that tax-exempt organizations derive UBTI from activities engaged in with an intent to make an investment rather than to actively participate in any of the unrelated trade or business activities generating the UBTI. Treasury and the IRS request comment regarding the specific factors that should be determined when considering whether an activity is an investment activity, for purposes of Section 512(a)(6). Accordingly, the IRS and Treasury attempted in Notice 2018-67 and the proposed regulations to permit an exempt organization to aggregate its investment activities as a single trade or business for purposes of Section 512(a)(6).

We agree that exempt organizations do not engage in investment activities with an intent to actively participate in an unrelated trade or business. In fact, as discussed in our prior submission which we reassert here, investment activities are not trades or businesses and, therefore, are not covered by Section 512(a)(6). If the IRS and Treasury were to finalize regulations defining investment activities as unrelated trades or businesses, we are concerned that such regulations will be subject to challenge and that a court would likely invalidate such regulations as a matter

of statutory interpretation and the applicable common law definition of trade or business. Moreover, in our judgment, the definition of "investments" and qualifying investment activities in the proposed regulations is too narrow and should be modified to comport with existing accounting standards that tax-exempt organizations with partnership investments already follow to distinguish non-operating investment activities from operating partnerships. Finally, if the IRS and Treasury were to finalize regulations retaining the control and de minimis tests rather than adopting those accounting standards for defining investment activities, then the control test should be modified to analyze only actual control, as opposed to ownership.

A. Why investment activity should not be treated as an unrelated trade or business

Section 512(a)(6) applies only to unrelated trade or business activities, whereas investment activities are not described as, and do not fit the definition of, unrelated trade or business activities in Sections 511-513 or elsewhere in the Code. The Code and regulations are clear that unrelated trade or business activities only include the "sale of goods" or the "performance of services" that are unrelated to the organization's mission. See Section 513(c). Treas. Reg. § 1.513-1(b) provides an overview of the purpose of the UBTI rules and the nature of unrelated trades or businesses to which those rules are meant to apply:

> [W]here an activity does not possess the characteristics of a trade or business within the meaning of section 162, such as when an organization sends out low-cost articles incidental to the solicitation of charitable contributions, the unrelated business income tax does not apply since the organization is not in competition with taxable organizations. However, in general, any activity of a section 511 organization which is carried on for the production of income and which otherwise possesses the characteristics required to constitute trade or business within the meaning of section 162—and which, in addition, is not substantially related to the performance of exempt functions—presents sufficient likelihood of unfair competition to be within the policy of the tax. Accordingly, for purposes of section 513 the term trade or business has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.
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> (emphasis added)

Investment activity is not considered a trade or business for purposes of Section 162 or other purposes of the Code because it does not involve the sale of goods or performance of services, or otherwise possess the characteristics of a trade or business. It is appropriate that the proposed regulations provide that qualifying investment activities should not be classified using NAICS codes, because the NAICS class codes, which are designed to describe different industries and businesses that sell goods and services to others based on a specific method of production, do not contain any code describing an organization investing its own funds for its own benefit.

The tax law distinguishes between profit-seeking trade or business activity and profit-seeking nonbusiness activities, the latter of which are composed primarily of investment activities. For instance, Section 162, to which Treas. Reg. § 1.513-1(b) refers for a definition of "trade or

business," allows taxpayers to deduct costs incurred in connection with a trade or business, but not costs incurred in connection with nonbusiness investment activities. Moreover, Section 212, which enables individual taxpayers to deduct certain investment expenses does not use the words "trade or business" to describe investment activities; rather, it provides that "[i]n the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—(1) for the production or collection of income; (2) for the management, conservation, or maintenance of property held for the production of income… ." The fact that Congress wrote a separate code section to provide for the deductibility of investment expenses reflects that Congress does not view such expenses as deductible under Section 162 and, therefore, that investment activity is not within the ambit of a "trade or business" under Section 513(c).

See our attached comments on Notice 2018-67 dated January 14, 2019 (Exhibit 1), for a fuller explanation of why investment activities are not "trade or business" activities subject to Section 512(a)(6).

B. Distinguishing investment activity from unrelated trades or businesses

If the IRS and Treasury were to treat investment activity as an unrelated trade or business, we offer the following recommendations for making the regulations more administrable: (1) use existing accounting standards and guidance that apply when preparing an organizations' audited financial statements to determine if a partnership is an investment or an operating business, (2) allow ERISA-covered plans to treat all of their partnership holdings as per se investments, and (3) treat all investments managed by registered investment advisors as QPI.

Please see Exhibit 2 for a background discussion on exempt organization tiered investments, and investment concepts that are relevant to our comments and recommendations.

1. Generally accepted accounting principles for financial statement reporting of investments are a more accurate means of identifying investment activities than ownership and control tests

Rather than looking at an exempt organization's profits or capital interests in a partnership to determine QPI status, its classification and treatment for financial reporting purposes should determine whether or not the partnership qualifies as a QPI. Under generally accepted accounting principles ("GAAP"), a partnership interest is accounted for in one of three ways, depending on the level of control and influence the exempt organization has over the partnership:

- Consolidation accounting (in accordance with ASC paragraph 958-810-15-4 or ASC paragraph 958-810-25-2 through 25-4). The financial results of a partnership interest must be included in an exempt organization's consolidated financial statements if the exempt organization has a controlling financial interest in the partnership. For legal entities other than limited partnerships, the usual condition for a controlling financial interest is ownership of a majority voting interest. For limited partnerships or similar legal entities (such as limited liability companies that have governing provisions that are the functional equivalent of limited partnerships), general partners are presumed to

control unless limited partners have either substantive kick-out rights (i.e., to dissolve the limited partnership or otherwise remove the general partners without cause) or substantive participating rights (i.e., to block or participate in significant financial and operating decisions of the partnership that are made in the ordinary course of business). Partnership interests requiring consolidation are generally reported as "Other Assets" on the exempt organization's Form 990 Part X line 15 to align with GAAP classification.

- Equity method accounting (in accordance with ASC paragraph 958-810-15-4). This method is generally required when an exempt organization has significant influence over the partnership but does not maintain a controlling financial interest in the partnership. An exempt organization that owns 20% or more of a voting interest in a partnership is presumed to have significant influence over the partnership. Likewise, an exempt organization is presumed not to have significant influence over a partnership in which it owns less than a 20% voting interest. A general partner of a limited partnership must also use the equity method of accounting if consolidation is not required (i.e., it fails the presumption of control). Partnership interests requiring equity method accounting are generally reported as "Other Assets" on the exempt organization's Form 990 Part X line 15 to align with GAAP classification.

- Fair value accounting (in accordance with ASC paragraph 958-321-15-2). Partnership interests that do not qualify for consolidation or equity method accounting, because of the partner's lack of control or significant influence, are accounted for at fair value, with unrealized holding gains and losses included in earnings. For certain partnership investments, not-for-profit entities may elect to use fair value accounting in lieu of equity method accounting. See ASC 954-810-15-3h and i for guidance applying to not-for-profit health care entities and ASC 958-810-15-4e for guidance applying to all other not-for-profit entities. Partnership interests using fair value reporting are generally reported as "Investments – Other" on the exempt organization's Form 990 Part X line 12 to align with GAAP classification, and detailed on Form 990 Schedule D Part VII.

We believe that partnership interests accounted for at fair value under GAAP (or that would be accounted for at fair value under GAAP, if the exempt organization were to apply GAAP) should be treated as QPIs, whereas partnership interests accounted for under the consolidation or equity accounting method (or that would be accounted for under the consolidation or equity accounting method, if the organization were to apply GAAP) should be treated as operating activities (rather than as investment activities) of the exempt organization and classified based on the appropriate two-digit NAICS code (subject to the applicability of the look-through rule for downstream holdings of that partnership).[2] This proposed method of identifying QPIs would accomplish the following:

[2] Likewise, government entities follow Governmental Accounting Standards Board (GASB) principles, which provide a near-identical accounting method for investments at fair value. Statement No. 72, Fair Value Measurement and Application, provides that "[A]n investment is defined as a security or other asset that (a) a government holds

- Provide a bright-line test easily determined by examination of the exempt organization's balance sheet.
- More closely align with Form 990, Part X, line 12 investment reporting.
- Enable the exempt organization investor to more easily determine and manage its separate unrelated trades or businesses.
- Require no additional analysis or reporting by fund managers who may not be able to identify UBTI from separate trades or businesses without significant administrative burden.
- Better identify an exempt organization's true investments (i.e. partnership interests that are part of its investment portfolio), versus partnerships that are extensions of its operating activities.

This method of distinguishing investments from operating partnerships would provide a more accurate reflection of control over partnerships than would the percentage ownership standards in the proposed regulations. It is inaccurate to equate ownership percentage with control for a limited partner, particularly in the investment world. For investment partnerships, exempt organization investors generally do not want control and do not have the expertise to exercise any control—that is why such investors hire professional investment advisors to make the investing decisions for them. They invest in partnerships that have appropriate parameters on investments (e.g. types of investments, domestic or international, whether the partnership can incur debt and the limits thereof) that they are comfortable with and that fit within the exempt organizations' investment policy statements. The actual investment decisions by the investment partnerships are left to the professionals that have teams of researchers and analysts who can make sound investment decisions.

The 20% capital interest threshold was described in the proposed regulations as being consistent with Section 731(c)(3)(C)(i). This provision, however, relates to gain recognition on the transfer of securities between investment partnerships, and is not as relevant or administrable as the accounting standards described above for distinguishing between investments and operating partnerships.[3]

2. Investments of ERISA-governed trusts and trusts that include ERISA assets should be treated as qualifying partnership investment activities aggregated as a trade or business

In evaluating how to apply the rules on identifying multiple unrelated trades or businesses to trusts of Section 401(a) qualified retirement plans that are subject to the Employee Retirement

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primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash.

[3] Similar to FASB, GASB prefers to report investments at fair value rather than using the equity method of accounting.

Income Security Act of 1974, as amended ("ERISA"), it would be helpful to consider how such trusts are required to operate under the ERISA fiduciary responsibility rules.

The persons responsible for the investment of the assets of trusts subject to ERISA are treated as fiduciaries of the trusts, subject to a series of fiduciary duties and other rules governing how they manage the "plan assets" of the ERISA plans held in the trusts. The first and foremost of these rules is the fiduciary duty to discharge responsibilities "solely in the interest of the participants and beneficiaries" of the plan, "for the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan." ERISA § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A). As such, their responsibility is to invest the assets of the trust in such a manner as to support the payment of benefits, not to operate a trade or business.

In practice, the primary driver of UBTI for ERISA-governed trusts, as well as trusts that include ERISA assets, is their investment in private equity funds, hedge funds, real estate holding companies and other "alternative investment" vehicles that are taxed as partnerships, not the plan or trust itself carrying out "trade or business" activities. This is because the focus of the investment activities of ERISA fiduciaries is to generate the income, preserve the principal, and maintain the liquidity needed to pay the retirement benefits provided for under the plan provisions to the plan's participants and beneficiaries, in order to meet their ERISA obligations.

The ERISA prohibited transaction rules provide an additional constraint on the activities of plan fiduciaries. These rules strictly limit the ability of the ERISA plan's trust to engage in transactions with persons who have certain relationships with the plan, so-called "parties in interest," as well as prohibiting fiduciary self-dealing and conflicts of interest, absent an available exemption. While there are a number of exemptions from the "party in interest" prohibited transaction rules, these are subject to a number of conditions. As a result, it would be difficult for ERISA fiduciaries to operate a trade or business through the trust itself, or through an entity that is treated under ERISA as holding "plan assets" subject to ERISA—generally private investment funds of which ERISA plans or individual retirement accounts hold a 25% or more in value of any class of the fund's equity interests. It is for this reason that many investment funds seek to avoid ERISA "plan asset" status, such as by limiting ERISA plan investment or qualifying for an exception, particularly in the case of private equity/venture capital funds and real estate funds that may engage in their regular course of business in a number of transactions that could implicate prohibited transaction issues.

The consequence of a person violating his or her ERISA fiduciary duties with respect to an ERISA-governed plan is personal liability for any resulting losses to the plan, as well as to restore to the plan any profits the fiduciary made through the improper use of the plan's assets. The person can also be subject to other equitable or remedial relief that a court may deem appropriate, including removal from his or her fiduciary position. ERISA § 409(a), 29 U.S.C. § 1109(a). For ERISA-governed plans and trusts that include ERISA assets, the additional liability for prohibited transactions is an excise tax on the party in interest engaging in the transaction with the plan under Section 4975 of the Code (which uses the term "disqualified person" in place of "party in interest") is 15% of the amount involved in the transaction for each

year until the transaction is corrected, plus an additional tax of 100% of the amount involved when an initial tax is imposed on a prohibited transaction and the transaction is not corrected within the taxable period.

As a result, the ERISA rules and related penalty provisions already provide sufficient controls to keep ERISA-governed plans, and trusts that include ERISA assets, from engaging in a trade or business. Consequently, all of their investments are engaged in as investments and investment funds are already incentivized to limit the ownership of ERISA-covered investors because the investment funds do not wish to be subject to the ERISA rules. Like other large tax-exempt organization investors, pension plans normally have substantial assets to invest, and investments through multi-tier funds and funds-of-one, as described above, are commonly utilized. Under the proposed regulations, significant administration would be required to separate investments between QPIs and other partnerships that may be subject to the look-through or NAICS codes, and in which the ultimate, bottom-tier investments are almost certainly under the 2% ownership threshold for the de minimis test. Accordingly, we recommend that ERISA-covered trusts and trusts that include ERISA assets be allowed to treat all of their partnership investments as qualifying investment activity, and to aggregate UBTI from those investments with UBTI from other qualifying investment activities in a single trade or business.

3. Investments managed by registered investment advisors should be treated as qualifying investment activities

Individual investors typically obtain investment management through mutual funds or brokers. Mutual funds may be more volatile than direct holdings in securities because they are subject to the flows in and out of the investment by a multitude of investors. Further, mutual funds have marketing costs to absorb as well, further reducing the potential rate of return. However, larger investors can tap into separate account managers and other highly skilled investment managers through more sophisticated investments that are less volatile because they don't have all the trading activity that mutual funds have. Separate account managers typically invest directly in bonds, stocks, etc. For the larger investors that need more specific types of investments, alternative investments allow for specialized professional managers to acquire a portfolio of investments (e.g., hedge funds, private equity funds) that meet the specific investment objective. As the size of an exempt organization's investable assets increase, economies of scale will normally indicate that an organization should consider direct non-public investments (through PE or hedge firms' funds, or otherwise). This approach can potentially allow an organization to lessen its risk profile.

Investing in such alternatives investments requires specific expertise. It is this expertise for which exempt organizations retain alternative investment managers to research and make decisions on underlying investments. In doing so, the tax-exempt investors relinquish control, in the form of investment discretion, to their investment managers. Further, many exempt organizations retain one or more investment advisers registered with and regulated by the U.S. Securities and Exchange Commission ("SEC") to manage their investments. Investors that retain these registered investment advisors ("RIAs") generally do so to allow the RIAs with relevant investing experience to make their own investment decisions about the investment portfolio, with

little or no direction or direct involvement from the exempt organization other than a requirement to comply with investment policies of the exempt organization, such as an Investment Policy Statement or a Socially Responsible Investment Policy.

Exempt organizations that retain RIAs regulated by the SEC to manage their investments exercise little or no direction or direct involvement in such investments. Rather, the RIAs make the investment decisions about the exempt organizations' investment portfolios. Accordingly, the regulations should not require investments managed by one or more RIAs to be treated as separate unrelated trades or businesses, but rather should allow exempt organizations to treat all such investments as qualifying investment activity, and to aggregate UBTI from those investments with UBTI from other qualifying investment activities in a single separate trade or business. More guidance is required in order to properly evaluate the impact of a change.

IV. Making the De Minimis and Control Tests More Administrable and Less Burdensome

To the extent the above recommendations are not implemented (meaning that the IRS and Treasury treat investment activity as an unrelated trade or business and retain the de minimis and control tests), then we recommend the following adjustments to the de minimis and control tests.

Tests Should Be Based on Actual Control, Not Ownership

As explained above and in Exhibit 2, it is common for exempt organization investors to hold a greater than 20% capital interest in a partnership, yet have no control over the partnership (e.g., fund-of-one partnerships, master-feeder structures). To comport with the IRS and Treasury's intention to allow exempt organizations to aggregate as qualifying investments those partnerships through which they do not actively carry on any trades or businesses, we recommend that Treasury and the IRS (i) replace its de minimis and control tests with the fair value accounting method standard for determining investment partnerships, as described above; or, (ii) if the IRS and Treasury are not willing to abandon the de minimis and control tests, that they instead eliminate the ownership percentage prong of the control test and modify the control prong of that test to comport with the more familiar and administrable ASC standards for consolidated and equity method accounting treatment (ASC paragraphs 958-810-15-4 and 958-810-25-2, as described above), which set forth the criteria below for determining control. downstream general partners.

- The exempt investor has a 20% or greater voting interest in the partnership;
- The exempt investor has substantive kick-out rights (i.e., to dissolve the limited partnership or otherwise remove the general partners without cause) in the partnership; or
- The exempt investor has substantive participating rights (i.e., to block or participate in significant financial and operating decisions of the partnership that are made in the ordinary course of business).

This would be consistent with the language and intent of Section 512(a)(6), while significantly minimizing burden for exempt organization investors and their investment managers.

Conversely, the following should not be deemed to constitute control over a partnership because they merely represent a means by which to monitor and protect an exempt organization investor's interest in its partnership investment rather than controlling that partnership:

- The ability to remove or replace a fund manager who manages the investment(s);
- The ability to appoint a member of an advisory board of the partnership; and
- The ability to withdraw from a partnership.

Aggregating interests of supporting organizations for control test

For those exempt organizations that are part of a very large affiliated group, the requirement to combine interests with supporting organizations can be particularly burdensome, as they may not know what all the affiliated organizations are, nor what their holdings may be. For example, assume an exempt organization is a member of the United States Conference of Catholic Bishops group exemption, and that the group includes a supporting organization that can support all Catholic Charities that are listed in the Official Catholic Directory. A local Catholic hospital may not be aware of the existence of such a supporting organization, may not have ever received any funds from such a supporting organization, and would have no ability to compel the organization to provide information regarding its holdings. Any overlap in holdings in a given investment likely would be by mere chance.

A similar issue could exist for a large national health system that has "systems" in each state whereby the exempt organization in one state may be aware of any supporting organizations in that state, but not of the "systems" in other states.

In addition, community foundations may have numerous supporting organizations that are managed by their respective donors but are not managed or responsive to the community foundation.

Accordingly, we propose that the requirement to aggregate ownership interests with those of supporting organizations be removed from Prop. Reg. §1.512(b)-6(c)(4)(ii), if the IRS and Treasury were to retain the control test in the final regulations.

Expand look-through rule to any downstream partnership interest that meets the de minimis test

The proposed regulations provide a "look-through rule" that allows exempt organization investors in partnerships in which it has a greater than 20% capital interest, but for which it fails the control prong of the control test, to treat as QPIs any downstream partnerships in which it has no greater than a 2% profits and capital interest. But the proposed regulations would not allow exempt organization investors to apply this rule within partnerships that they control.

As a practical matter, an exempt organization that is deemed to exercise "control" over a partnership, however control is defined in the final regulations, is very unlikely to exert any actual control over downstream partnership in which it has no more than a 2% capital or profits interest, or even a 20% capital interest. Instead, such control would be exercised by the general partners and investment managers of those downstream partnerships. Preventing a look-through

exception that allows for looking through all of the ownership layers down to the operating business, regardless of the exempt organization investor's level of ownership or control of the upper-tier fund, would impose an undue burden and tax cost to the exempt organization because the investment would not qualify as a QPI under the proposed regulations. However, the rationale for applying the look-through rule applies equally to such lower-tier partnerships, whether downstream of an upper-tier partnership that the exempt organization investor does or does not control. Accordingly, if the IRS and Treasury were to retain the de minimis and control tests, the final regulations should allow exempt organizations to apply the look-through rule to any of downstream partnership interests that qualify as "qualifying investment interest" on their own merits, however that term is defined in the final regulations.

Furthermore, the look-through rule should apply equally to the control test as it applies to the de minimis test, meaning that any downstream partnership that is not under the organization's control should similar qualify as a QPI. The rationale for adopting the look-through rule applies equally to interests that are considered an investment because the organization meets the control test.

Transition Rule

The Proposed Regulations provide a "Transition rule for certain partnership interests," which allows an exempt organization to treat any partnership interest acquired prior to August 21, 2018 that fails to meet either the de minimis or control tests as a single unrelated trade or business, without regard to the number or type of underlying activities carried on by the partnership. The transition rule does not allow the exempt investor to aggregate UBTI from any other partnerships, even those that qualify under the transition rule.

Under the proposed regulations, the relief provided under the Transition rule will not apply to investments entered into after August 21, 2018. Also, the Transition rule is only temporary; it would sunset the first day of an organization's first tax year after the date the final 512(a)(6) regulations are published. After that date, exempt organization investors would need to report each unrelated trade or business activity within an investment partnership that does not meet either the de minimis or control test as a separate activity, even if that investment had previously satisfied the Transition rule.

Notice 2018-67, which promulgated an earlier version of the transition rule, explained the rationale for providing the rule: "A previously acquired partnership interest may be difficult to modify to the de minimis test or control test and the exempt organization may have to incur significant transaction costs to do so." This rationale is as applicable today as it was when 2018-67 was issued. Prior to Notice 2018-67, exempt organizations invested in partnerships without any expectation that they might need to obtain detailed information from general partners and fund managers on specific unrelated trade or business activities and debt-financed investments of that partnership or downstream partnerships. Accordingly, they would not have negotiated any requirement for general partners to provide this information, and now lack the leverage to require it. Terminating an organization's ability to rely on this rule to treat a single partnership as a single unrelated trade or business would impose a significant (and in some cases unbearable)

burden on organizations to obtain information that they either won't be able to obtain or won't be able to obtain without significant cost and effort, from a partnership that they do not control. And to the extent they are only investing in a partnership they do not control rather than operating a joint venture, they generally will lack the ability to negotiate or enforce such rights in future investments. Thus, if IRS and Treasury do not follow our recommendations to (i) exclude all investment activity from 512(a)(6) or (ii) treat all non-operating partnerships as a single unrelated trade or business, then we recommend the following modifications to the Transition rule:

- Remove the "transition" qualification from the rule, so that it applies to any and all investments (not operating partnerships or joint ventures) that don't qualify as "qualifying investment interests," however that term is defined in the final regulations;
- Remove the sunset provision from the rule, so that it continues indefinitely, beyond the effective date of the final regulations; and
- Continue to provide that partnerships that meet the rule must be treated as separate unrelated trades or businesses, but allow exempt organizations to apply the look-through rule to such partnerships to treat any downstream partnership interests that qualifies as a "qualifying investment interest," however that term is defined in the final regulations.

Reasonable Effort Standard

If Treasury and the IRS were to finalize regulations that include some version of the de minimis and/or control test, we recommend that the final regulations provide that exempt organizations are required only to make a reasonable effort to determine what types of unrelated trade or business activities were engaged in by partnerships in which the organizations had ownership interests, and which did not meet the definition of "qualifying partnership interests" for purposes of determining the NAICS codes used to classify such unrelated trades or businesses.

As explained above, certain partnerships in which an exempt organization has a capital interest above 20% have multiple (sometimes hundreds of) downstream partnership investments that generate different types of UBTI. Even if the exempt organization participates in the management or business operations of the partnership or exercises some degree of control over the partnership, it generally has little or no ability to ascertain all downstream sources of UBTI that it ultimately derives from the downstream partnerships. Even if the exempt organization were successful in negotiating an agreement with the general partner of the partnership to provide what information on such UBTI the general partner is able to obtain, it generally would be very difficult, if not impossible, for that general partner to obtain information on (i) all downstream sources of UBTI and (ii) what amount of total UBTI from each downstream partnership is attributable to each UBTI source. The less a partnership's interests are in a downstream partnership, the less likely it is that the partnership will have the leverage or ability to obtain that information.

Given these constraints on an exempt organization investor's ability to obtain information on UBTI sources from its partnership investments, an absolute requirement that such organizations

obtain that information would either be impossible to meet or impose a very heavy, costly burden on many exempt organizations. To make such a requirement more administrable, we recommend that, to the extent the final regulations maintain some version of the de minimis or control tests, they permit an exempt organization to report UBTI derived from its partnership interests as being from "other services" (NAICS code 81) if it is not able to determine whether the UBTI is derived from a qualifying partnership interest or a particular trade or business, after making a reasonable effort to obtain information on such UBTI source(s). Such reasonable efforts could include, but not be limited to, distributing a questionnaire to the general partner of the partnership in which it directly invests to request such information. More guidance is required in order to properly evaluate the impact of a change.

V. Special Considerations for Social Clubs, VEBAs, and SUBs

The requirement to separate UBTI into separate trades and businesses based on NAICS code will be especially burdensome for social clubs because these organizations are generally small and non-member services will often span a range of codes. Forcing social clubs to separate their UBTI by NAICS code will likely result in very small amounts of UBTI in a wide number of categories due to the services offered to non-members. We are concerned that this will encourage social clubs to offer fewer, if any, non-member services, which could in turn diminish the role of social clubs more generally. Non-member revenue is already limited through the restriction that no more than 35% of a social club's revenue can come from non-member sources generally, and only 15% can come from non-member use of facilities and services. We propose that all non-member activity, at least under a specified threshold, be allowed to be considered one category of UBTI. This would greatly alleviate the administrative burden of the proposed regulations on social clubs, and take into account that this type of revenue is already quite limited.

Another potential unintended consequence is that because there is a charitable set-aside permitted under the proposed regulations, there may be increased incentives for social clubs to create affiliated charitable funds or charitable organizations to take advantage of the set-aside.

The IRS has requested comments on any unintended consequences, in areas other than UBIT, resulting from the treatment of investment activity as an unrelated trade or business for purposes of section 512(a)(6) for VEBAs and SUBs. We are concerned that this treatment could encourage VEBAs and SUBs to create more complicated investment structures (for example, increased use of blocker corporations) or could encourage VEBAs and SUBs to consider more conservative investment strategies than merited based on their asset values.

The IRS has also requested comments outlining particular facts and circumstances that should be considered by a social club when determining whether a non-recurring event should be treated as a separate unrelated trade or business, part of a larger trade or business, or as part of a social club's investment activities for purposes of section 512(a)(6). We believe that this inquiry should largely be the same as the determination of separate trades and businesses more generally for tax-exempt organizations. However, because social clubs are likely to have non-member income, some specific guiding questions should be: (i) what is the purpose of the activity? (ii) Is there a profit motive? (iii) what is the scope of the activity? (iv) what is the expected or known duration

of activity? (v) are there other similar activities conducted by the social club? and (vi) is this an outgrowth of a larger trade or business activity?

VI. Treatment of Income from Section 512(b)(4), (13), and (17)

Notice 2018-67 did not state a position on how income generated under Sections 512(b)(13), 512(b)(4) and 512(b)(17) should be addressed and instead asked for comments. The Notice observed that tracking and reporting income from each controlled entity separately could be burdensome for both exempt organizations and the IRS. Our comments suggested that there be one silo for all UBTI created by statutory provisions such as Section 512(b)(13), 512(b)(4), 512(b)(17), and 512(c). However, the Proposed Regulations take the approach of separate silos for payments for each controlled entity—the approach the Notice indicated could be burdensome. We agree that it is burdensome and, further, that the approach taken in the Proposed Regulations is undesirable because similar fact patterns can produce different tax results.

First, excluding Section 512(b)(13) from the investment silo can produce varying results because of the interaction of Sections 512(b)(13) and the debt-financed property rules. This is illustrated by the following example.

Example 1

An exempt organization ("EO") borrows funds to buy a building for $100,000. $50,000 in debt remains outstanding. EO leases the building to its wholly owned taxable subsidiary. All activities of the taxable subsidiary would be UBTI if they were conducted by EO. EO receives $10,000 in rent. EO's expenses relating to the building are $2,500 interest on the debt and $2,500 depreciation.

Scenario 1: Subsidiary does not deduct rent. The subsidiary operates at a loss before deduction of the $10,000 rent. Therefore, no amount of the rent payment to EO is taxable under Section 512(b)(13). All of the rent is therefore evaluated for taxability under Section 514. One-half ($50,000/$100,000) of the rent is gross income from debt-financed property. One-half of EO's deductible expenses are $2,500. Therefore, EO has $2,500 in net UBTI from debt-financed property that goes into the investment silo.

Scenario 2: Subsidiary deducts rent. The subsidiary has positive taxable income after deducting the entire amount of rent paid. Therefore, all of the rent income is taxable under Section 512(b)(13). EO has $5,000 in net UBTI that is in a separate silo of Section 512(b)(13) income from that subsidiary.

Scenario 3: Subsidiary deducts part of rent. Before deducting rent, the subsidiary has $5,000 in positive taxable income. $5,000 of the rent paid will reduce the subsidiary's taxable income so this amount is included in EO's gross UBTI. After deducting the proportionate amounts of interest and depreciation, EO has $2,500 in net UBTI in a separate silo of Section 512(b)(13) income from that subsidiary. The remaining $5,000 is evaluated for debt-financed property status. One-half of

the remaining $5,000 in rent, or $2,500, is gross UBTI from debt-financed property. After deducting the proportionate amounts of interest and depreciation, EO has $1,250 in net UBTI from debt-financed property that goes into the investment silo. Total net UBTI is $2,500 plus $1,250 or $3,750, split between two silos.

In these three examples, the total net UBTI varies from $2,500 to $5,000, but the amount in a separate Section 512(b)(13) silo varies from 0 to $5,000, in both cases solely on the basis of the taxable subsidiary's overall profitability. If the separate Section 512(b)(13) silo did not exist and Section 512(b)(13) income was included in the investment silo, the "silo" effect would not occur and the net UBTI would have the tax effect prescribed under Sections 512(b)(13) and Section 514.

Second, if Section 512(b)(13) income remains excluded from the investment silo, at least an exempt organization's Section 512(b)(13) income from all controlled organizations should be included in one silo. If Section 512(b)(13) income from each controlled organization is treated as a separate silo, as proposed in the Proposed Regulations, similar economic arrangements will result in different amounts of taxable income based on corporate arrangements, presenting opportunities for more sophisticated EOs to minimize taxable income while less sophisticated EOs do not.

Example 2

Assume an exempt organization ("University") has two controlled organizations, a tax-exempt organization named Sub A and a taxable corporation named Sub B. Sub A operates the campus stadium when the stadium is rented to promoters for concerts and other events. Sub A's only activity unrelated to exempt purposes is renting the stadium. Sub B operates the campus bookstore. Twenty percent of Sub B's business is sales to persons other than students and employees; assume such sales would be an unrelated trade or business if conducted by an exempt organization. Each of Sub A and Sub B occupy property that is owned by the University and that was not debt-financed. Sub A pays $10,000 and Sub B pays $100,000 in rent on property owned by the University annually.

Scenario 1. University controls Sub A and owns all the stock of Sub B. Sub A receives $20,000 in rent for the stadium. Sub A has $25,000 in expenses in operating the stadium for these events, in addition to the $10,000 it pays University in rent. Under the approach of the Proposed Regulations of one silo per controlled entity, the University has net UBTI of $0 from Sub A because the rent paid to the University does not reduce Sub A's UBTI. Sub B, on the other hand, nets $200,000 from all of its activities before payment of rent, and $100,000 after payment of rent. Twenty percent of Sub B's income would be UBTI if it were exempt. Assume expenses are the same for each dollar of related and unrelated income. Sub B's hypothetical UBTI is reduced by $20,000 of the rent it pays the

University. Thus, University has two silos of Section 512(b)(13) UBTI: $0 from Sub A and $20,000 from Sub B.

Scenario 2. University controls Sub A and Sub A owns all the stock of Sub B. University leases the stadium to Sub A for events and also leases to Sub A the property used by Sub B for the bookstore. Sub B pays $100,000 in rent to Sub A. Of the $100,000, $20,000 is gross UBTI to Sub A under Section 512(b)(13). Sub A pays $110,000 in rent to University. Sub A's gross UBTI is $20,000 from Sub B and $20,000 from promoter rents. Sub A has $55,000 in expenses related to the gross UBTI: $20,000 in rent it pays to University for the unrelated use of the bookstore; $25,000 in operating expenses for the stadium; and the $10,000 in rent it pays to the University for the stadium. Thus, the rent Sub A pays University reduces Sub A's UBTI by $15,000.

Accordingly, in Scenario 2, University's Section 512(b)(13) income is in one silo and is $15,000, which is $5,000 less than in Scenario 1, simply by having Sub A own Sub B and running the lease of University's property through Sub A.

Accordingly, we continue to recommend that that there be one silo for all UBTI created by statutory provisions. More guidance is required in order to properly evaluate the impact of a change.

VII. Treatment of S corporation interests

As a general matter, S corporations are not the form of choice for exempt organizations seeking to make new investments. This disfavored treatment results primarily from the treatment of S corporation interests under Section 512(e) of the Code, which requires an organization to take into account in computing its UBTI from an S corporation all items of income, loss or deduction taken into account under Section 1366(a), and any gain or loss on the disposition of the stock in the S corporation. Section 512(e)(2) contains a basis adjustment rule that requires an organization which acquired its S corporation interest by purchase to reduce its stock basis for any dividends received with respect to the stock.

Most commonly, organizations would opt for making new investments in partnerships, single member LLCs, or through direct ownership—all of which are substantially more tax efficient and easier to transfer than S corporation interests. In considering how UBTI from an S corporation interest should be treated for purposes of Section 512(a)(6), we feel it is useful to understand why an organization would hold an S corporation interest. In the normal course, an organization holds such interests because they were received by gift or bequest (i.e., they were acquired by means other than by purchase). Commonly held views of donee charities and donors are discussed below.

From the perspective of a donee organization, the question of whether to accept an S corporation interest by gift or bequest commonly necessitates an analysis of whether the receipt, holding, and potential disposition of such property makes financial sense for the organization, taking into account the legal and tax administrative and compliance burdens.

From the perspective of a donor, gifts or bequests of S corporation interests to charity may be essential elements of their income or estate tax plans. In some cases, donors anticipate a sale of the activities within the S corporation, or in other cases, they simply want the value to accrue to the charity either during their lifetime or upon death. Some such gifts or bequests are made to community foundations and other organizations that sponsor donor advised funds or supporting organizations, as opposed to the general funds of the intended donee.

A question then arises as to why a donee organization might not sell an S corporation interest immediately upon receipt. First, if the exempt organization expects (or is told to expect) a sale where a significant gain can be achieved, it would be imprudent to sell the interest immediately upon receipt. Instead donee would wait until the S corporation is sold as a whole or liquidated. By their nature, S corporations are closely held (the number of shareholders are limited in type and number), which makes it more difficult for the exempt organization to sell its interest. Further, some S corporations have buy/sell agreements that further limit who the interests may be sold to. Additionally, in some cases the immediate sale of donated property would alienate the donor, risking future donations from the same individual.

We recommend that Section 1.512(a)-6(c)(1)(ii) of the Proposed Regulations be revised to permit an organization to treat all S corporation interests as investment activities, regardless of the organization's ownership percentage in the S corporation.

In the first alternative, we recommend that the Section 1.512(a)-6(e)(2) term "qualifying S corporation interest" be revised to include any S corporation interest the organization acquired other than by purchase, regardless of ownership percentage.

In the second alternative, we recommend that the term "qualifying S corporation interest" be revised to include any S corporation interest the organization acquired other than by purchase, regardless of ownership percentage, that is disposed of within five years of receipt (and that an extension for a second five-year divesture period be permitted in certain cases).

Lastly, if the recommendations above are not adopted, we respectfully request that matters related to the tax treatment of S corporation interests be reserved for future guidance and that an interim rule be provided until such future guidance is issued.

These recommendations are explored more fully below.

<u>Our recommendations</u>

We recommend that Prop. Reg. §1.512(a)-6(c)(1)(ii) be revised to permit an organization to treat all S corporation interests as investment activities, regardless of the organization's ownership percentages in the S corporations, due to the nature of these interests.

If this change is not accepted in its entirety, we suggest that non-voting shares of an S corporation be disregarded for purposes of determining stock ownership. Non-voting shares clearly do not provide any degree of control by the owner.

Alternatively, we respectfully request that the IRS and Treasury Department establish a rule of administrative convenience that would permit an organization to treat all interests in

S corporations acquired other than by purchase as qualifying S corporation interests for purposes of Prop. Reg. §1.512(a)-6(e)(2). Such a rule would give effect to the long-standing views of the IRS and Treasury Department that investment assets acquired by a tax-exempt organization by gift or bequest are taxed in a fundamentally different way than those that the organization willfully acquires by purchase. In this regard, we believe that the precedent found in the Section 4944 jeopardy investment and Section 4943 excess business holdings rules that apply to private foundations would provide familiar and workable frameworks that could be adopted here. Such treatment also would be consistent with Section 512(e), which already contemplates a different basis rule for interests in S corporations than an organization acquired by purchase.

First, the adoption of a rule that permits all S corporation interests to be treated as qualifying S corporation interests that draws on the principles of the Section 4944 jeopardy investment rules could be easily administered both by tax-exempt organizations subject to Section 512(a)(6) and the IRS. Generally, the Section 4944 jeopardy investment rule applies to investments "made" by a private foundation. Under Section 53.4944-1(a)(2)(ii)(a) of the Treasury regulations, the jeopardy investment rules do not apply to an investment which is gratuitously transferred to a private foundation. In the Section 512(a)(6) context, a similar bright line rule easily could provide that all S corporation interests received by a tax-exempt organization by gift or bequest may be treated as qualifying S corporation interests. Such a rule would reduce administrative burdens for tax-exempt organizations and provide for an administrable examination process for the IRS. For example, information obtained and retained by the tax-exempt organization for use in the preparation of its Schedule B (Form 990-EZ, 990, 990-PF), Schedule of Contributors, would provide a clear, auditable record of assets received by gift or bequest and ordinarily could be expected to be provided during an examination to substantiate why certain investment assets are included in the "investment activities" silo for Section 512(a)(6) purposes.

If a rule of administrative convenience that is modeled after the Section 4944 rules is not adopted, we respectfully request that the IRS and Treasury adopt a rule of administrative convenience that draws on the principles of the Section 4943 excess business holdings rules. Under Section 4943(c)(6), special treatment exists for private foundations that acquire otherwise-taxable interests in business enterprises other than by purchase, provided that any excess interests are disposed of within a five-year period. For example, a private foundation that receives a gift of a controlling interest in an S corporation would have five years to reduce (or eliminate) its ownership percentage before the Section 4943 tax could be assessed. This period can be extended for another five years under Section 4943(c)(7). Given that many organizations that receive investment assets by gift or bequest liquidate them within five years, a five-year divesture period (during which time all such investment assets could be treated as qualifying S corporation interests) would permit the majority of such organizations to either liquidate such assets or affirmatively decide to retain them. As a transitional matter, the five-year period should begin as of (i) the date of adoption of the final rule (for assets held on such date) or (ii) the date the investment asset is acquired, whichever is later. However, it may be prudent for the IRS and Treasury Department to allow for a two-year extension for any investment assets that a tax-exempt organization has been unable to dispose of due to the size and complexity or diversity of

such a holding (similar to the five-year extension already available to private foundations under Section 4943(c)(7)).

As discussed above, we believe that a rule of administrative convenience that provides for different treatment of investment assets that are acquired other than by purchase (either permanently or for a period of not less than five years) is warranted. If such a rule is not adopted, we respectfully request that the IRS and Treasury reserve for future guidance rulemaking associated with the holding and disposing of S corporation interests to permit sufficient time for additional notice and comment. Although many of the issue areas presented by the holding of S corporation interests overlap with those of other investment assets (e.g., limited partnership interests), S corporation interests present unique challenges. For example, although an exempt organization arguably could house most of its UBI-generating activities and investment assets in a wholly-controlled taxable subsidiary and thereby reduce the income from one activity with deductions from another, the same is not true with respect to S corporation stock. A C corporation is not an eligible S corporation shareholder.

If this question is reserved for future guidance, we request that the IRS and Treasury make clear in formal guidance that an organization that holds interests in S corporations that are not otherwise within the Proposed Regulations' definition of qualifying S corporation interests may, until the issuance of specific guidance on point, (i) treat all S corporation interests as qualifying S corporation interests, (ii) treat all such S corporation interests as a single trade or business activity reportable on a single Schedule M (Form 990-T), Unrelated Business Taxable Income from an Unrelated Trade or Business, or (iii) group related S corporation interests by the 2-digit NAICS code that most accurately reflects the primary trade or business in which the S corporation itself is engaged. Requiring that a single S corporation interest be regarded as its own separate trade or business (i.e., as its own "silo") for these purposes adds complexity and burden in a space where neither is required or warranted.

VIII. Allocation of Expenses Between Exempt and Non-Exempt Activities and Between Multiple Unrelated Trades or Businesses

A. Clarify that the Unadjusted Gross-to-Gross Method is Reasonable if there are no Pricing Differences

The final regulations should clarify that allocating expenses, depreciation, and other similar items using an unadjusted "gross-to-gross" method is reasonable if the pricing of the good or service does not vary depending on to whom the good or service is offered. Without pricing differences between goods or services offered as part of an organization's exempt function and goods or services offered as part of a nonexempt function, adjustments to the gross-to-gross method are not necessary. For example, if a school that operates a ski facility for use in its physical education program and for recreational use by its students and the general public charges the same slope and ski lift fees to members of the general public as it charges to students, no adjustment to the gross-to-gross method is necessary. See Exhibit 4 for two detailed examples of the dual use cost allocations for conference center catering.

B. Establish Safe-Harbor Allocation Methods

Treasury and IRS should issue proposed regulations establishing certain safe-harbor allocation methods for exempt organizations to utilize when allocating expenses between exempt and non-exempt activities and between multiple unrelated trades or businesses. The safe-harbor allocation methods should be established methods that are commonly used by exempt organizations for other purposes, including tax and non-tax purposes. Establishing safe harbors would ease the burdens of tax preparation by exempt organizations and simplifying auditing by the IRS. The proposed regulations should provide that allocation of expenses based on one or more of the following methods is deemed to be reasonable.

i. Allocation based on Facility Usage (Space, Time, and Units)

Many exempt organizations allocate facility costs such as rent, mortgage interest, insurance, property taxes, security, and utilities based on the portion of the facility used for each activity, as measured by square footage, time, and/or units. For example, if an exempt organization owns a building subject to a mortgage that is treated as acquisition indebtedness under IRC 514 and rents a portion of the building to unrelated third parties, the rental income therefrom will be debt-financed income subject to UBIT. If the total building square footage is 10,000 and 2,500 square feet is rented to unrelated third-parties, then 25% (2,500 ÷ 10,000) of the building costs are allocated to the debt-financed rental income.

A time-based methodology may also be used in combination with a space-based methodology. For example, if 5,000 square feet in the building is used to provide catering services for both related and unrelated activities and the catering space is used for unrelated activities 25% of the time, then 12.5% (50% x 25%) of the building costs are allocated to the unrelated catering activities. Organizations using a time-based methodology should be permitted to allocate facility expenses using any of the three methods below:[4]

- Number of days used for unrelated activities divided by 365 (or number of days in tax year if less).[5]
- Number of days used for unrelated activities divided by number of days available for use in all activities.
- Number of days used for unrelated activities divided by number of days actually used for all activities.

[4] The American Institute of CPAs (AICPA) has also suggested methods for allocating facility expenses based on the number of days the facility is used. *See* Letter from AICPA to Ms. Victoria Judson, Associate Chief Counsel (TEGE) and Ms. Janine Cook, Associate Chief Counsel (TEGE), Re: Unrelated Business Income Expense Allocation Methodologies for Dual Use Facilities (Dec. 2, 2015), available at https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/2015-12-02-aicpa-comment-letter-eo-ubi-dual-use-facility-expense-allocation-methodologies.pdf.

[5] The Tax Court ruled that this allocation method was reasonable in *Rensselaer Polytechnic Institute v. Commissioner*, 79 T.C. 967 (1982), *aff'd* 732 F.2d 1058 (2d Cir. 1984).

Insofar as the first method involves less record-keeping than the second and third (the organization need only maintain detailed records regarding the number of days used for unrelated activities), the IRS and Treasury might wish to specify that this method is available to organizations below a certain revenue threshold. Similarly, the IRS and Treasury might wish to include revenue thresholds for the second and third methodologies.

The proposed regulations should also identify allocation of expenses based on units of usage as a reasonable method. This method would potentially allow for a greater range of expenses to be allocated when compared to space- and time-based methods. For example, if University Y operates a recreational center that is available for use only by students, faculty, and alumni, and University Y determines that alumni used the facility 2,500 times during the year, and that students and faculty used the facility 7,500 times, the University could allocate the expenses to operate the facility accordingly: 25% (2,500 ÷ 10,000) of the costs of operating the recreational center (including building costs, administrative costs and costs of recreational center employees) would be allocated to the unrelated trade or business.

ii. Ratio of Direct Costs to Allocable Costs

This methodology allocates indirect costs shared between exempt and non-exempt activities and/or between multiple trades or businesses based on a ratio of direct costs to total costs.

Example: Exempt Activity A has direct costs of $5,000, Business B has direct costs of $3,000, and Business C has direct costs of $2,000. The allocation of shared indirect costs is 50% to Exempt Activity A, 30% to Business B, and 20% to Business C.

iii. Cost Allocation Methodology for Universities in OMB Circular A-21

OMB Circular A-21 ("A-21")[6] provides principles for determining the costs applicable to research and development, training, and other sponsored work performed by colleges and universities under grants, contracts, and other agreements with the federal government.[7] Generally, A-21 states that costs allocable to a federal project must be reasonable, allocable, and given consistent treatment through the application of generally accepted accounting principles. The National Association of College and University Business Officers (NACUBO) previously submitted a draft revenue procedure to the IRS based on principles established in A-21.[8] The detailed methodology set forth in the draft revenue procedure should be identified as a reasonable allocation method.

[6] OMB Circular A-21 was republished in 2 C.F.R. Part 200.

[7] IRS examination guidelines for colleges and universities direct agents to review OMB Circular A-21 information. *See* Ann. 94-112, 1994-37 I.R.B. 1 (Aug. 25, 1994).

[8] A Portable Document Format (PDF) version of the draft revenue procedure is available at www.nacubo.org/documents/business_topics/DraftRevenueProcedureFINAL.pdf.

iv. Cost Allocation Methodology for Medicare Cost Reporting ("Step Down")

The IRS should identify Medicare's "step-down method" of cost reporting as a reasonable method to allocate expenses between exempt and non-exempt activities and between multiple unrelated trades or businesses. The step-down method calculates costs using a three-step process:

1. Hospitals determine their cost of providing all services.
2. Hospitals determine which costs are allowable for Medicare purposes. Costs are allowable for Medicare purposes if (i) the costs related to patient care; and (ii) qualify for Medicare reimbursement.
3. Hospitals then calculate Medicare's share of allowable costs based upon the hospital's charges and Medicare beneficiaries' proportionate use of the facilities.

v. Cost Allocation Methodology for Lobbying Activities in Treas. Reg. §1.162-28

Treas. Reg. §1.162-28 provides a non-exclusive list of reasonable methods for allocating costs between lobbying and nonlobbying activities. These methods include the ratio method and the gross-up method.[9]

1. Ratio Method

Under the ratio method, an organization multiplies its total costs of operations by a fraction. The numerator of the fraction is the organization's lobbying hours and the denominator is the organization's total labor hours, resulting in the formula below:

Lobbying labor hours.

- X Total costs of operations.

Total labor hours.

An organization may use any reasonable method to determine the number of labor hours spent on lobbying activities and may make reasonable assumptions concerning total hours spent by the organization's personnel trade.

Using the "ratio method," an exempt organization would allocate personnel expenses between exempt and non-exempt activities and between multiple unrelated trades or businesses by multiplying its total costs of operations by a fraction, the numerator of which is labor hours spent on the non-exempt activity/unrelated trade or business and the denominator is total labor hours.

[9] Treas. Reg. §1.162-28(b)(1) also lists the uniform capitalization (UNICAP) rules under IRC 263A as a reasonable method for allocating lobbying costs. However, given the complexity of this method, very few taxpayers use it, so it is not discussed here. Nevertheless, the proposed regulations under Treas. Reg. §1.512(a)-1 should identify the UNICAP rules as one of the safe-harbor reasonable methods of allocating expenses.

2. Gross-up Method

An organization using the gross-up method multiplies its "basic labor costs" (e.g., wages) for lobbying labor hours by 175 percent, resulting in the formula below.

175% x Basic lobbying labor costs of all personnel

Alternatively, an organization may treat as zero the lobbying costs of personnel who engage in secretarial, clerical, support, or other administrative activities (as opposed to activities involving significant judgment) and multiply its basic lobbying labor costs by 225% instead of 175%. An exempt organization using the gross-up method (or alternative gross-up method), would multiply the costs of employees' compensation for time spent on the non-exempt activity/unrelated trade or business by 175% (or 225% if the costs of personnel engaged in secretarial, clerical, support, or other administrative activities are excluded under the alternative gross-up method).

vi. "Net-to-Net" Allocation

This methodology allocates indirect expenses between exempt and non-exempt activities and/or between multiple trades or businesses based on the ratio of shared indirect expenses to the total revenue generated by the activities after deduction of direct expenses from such activities.

Example: after applying direct expenses attributable to Exempt Activity A, Business B, and Business C, respectively, exempt organization has $12,000 of income from Exempt Activity A, $5,000 of income from Business B, and $3,000 of income from Business C. Shared indirect expenses for A, B, and C total $4,000.

$2,400 of indirect expenses ($4,000 times $12,000 ÷ $20,000)) are allocated to Exempt Activity A.

$1,000 of indirect expenses ($4,000 times $5,000 ÷ $20,000) are allocated to Business B.

$600 of indirect expenses ($4,000 times $3,000 ÷ $20,000) are allocated to Business C.

vii. Cost Allocation Studies

The Treasury Department and the IRS should consider specifying that exempt organizations may utilize cost studies for a period of 10 years (after the tax year in which the study is complete) as a reasonable method to allocate overhead expenses. For example, if an exempt hospital conducted a study of time spent by various departments on unrelated trades or businesses, and various indirect costs incurred by the hospital in conducting the activity, the hospital should be allowed to use the results of the study through 2030.

Example: In its 2020 tax year, Hospital X determined that its executive office, legal department, and finance departments spent on average 5% of their time on unrelated trades or businesses. Hospital X may rely on the 2020 study and apply the 5% rate to calculate the personnel costs of its executive, legal, and finance departments that are allocable to unrelated trades or businesses through 2030.

C. Permit Certain Fees and Expenses to be Deducted Against Total UBTI After Applying IRC 512(a)(6)

Certain expenses are notably difficult to accurately allocate between multiple trades or businesses and/or between exempt activities and non-exempt activities. Prior to release of the proposed regulations, the IRS acknowledged one such type of deduction by changing the structure of the 2019 Form 990-T by moving charitable deductions "below-the-line" to Part III, Line 34. In this way, a charitable contribution deduction was taken against total UBTI rather than allocating the charitable contribution among unrelated trades or businesses. This was fair and we support this change. Certain other expenses should likewise be deductible on Part III of Form 990-T, without having to be apportioned among the siloes.

i. Tax Return Preparation Fees and State Taxes

Specifically, tax return preparation fees and state income and franchise taxes should be deducted against total UBTI as "below-the-line" deductions on Part III of Form 990-T. Tax preparation fees relate to all an organization's unrelated trades or businesses and should therefore apply to all UBTI after application of IRC 512(a)(6). Many exempt organizations with multiple unrelated trades or businesses pay a flat fee to their paid preparer for the Form 990-T and a flat fee per-state for all state income or franchise tax returns the organization is to file. Both tax return preparation fees and state income or franchise taxes paid are common deductions for most (if not all) Form 990-T filers.

Tracking or allocating these tax return preparation fees and state income and franchise taxes to each trade or business is virtually impossible because of the same circular references which necessitated the charitable deduction change. Some states have a minimum franchise tax that must be paid, regardless of the extent of the organization's activity. Organizations that register in a state and start filing income or franchise tax returns often continue filing those returns even when the organization no longer has a return filing requirement due to the administrative cost and effort of cancelling a state registration and filing a final return.

ii. Investment Management Fees

In certain circumstances, exempt organizations should be permitted to deduct investment management fees. Thus, we believe that a line should be added for investment management fees in Part III of Form 990-T. Exempt organizations may have multiple investment activity siloes, such as those with multiple investments in pass-through entities that generate UBTI and do not satisfy either the de minimis or control tests. To the extent that our recommendations for investment activity above are not adopted, allocating investment management fees between multiple investment siloes is problematic because the organization must rely on the recordkeeping of their investment management firm. Many firms are unable to allocate investment management fees to particular investments. Thus, organizations with multiple investment activity siloes should be permitted to deduct investment management fees against total investment-related UBTI.

IX. Net Operating Losses

In interpreting the Proposed Regulations, questions remain in applying the pre-2018 and post-2017 net operating loss ("NOL") ordering rules regarding to what extend pre-2018 NOLs should be allocated among different trades or businesses, what constitutes "taxable income" under 512(a)(6) for purposes of imposing the 80% limit under section 172(a)(2)(B)(ii)(I), and how to apply the loss carryback provisions under the CARES Act within the context of section 512(a)(6). As a general matter, recommend that all guidance regarding NOLs reflect Congress's intent under the CARES Act to provide additional flexibility and relief during the economic crisis following the COVID-19 global pandemic.

We recommend that final regulations clarify and address the following issues:

A. Allocation of Pre-2018 NOLs

The Proposed Regulations provide for the use of pre-2018 NOLs before deducting any post-2017 NOLs. Per the Proposed Regulations, the intent of this ordering is to provide for the use of pre-2018 NOLs in a manner that results in maximum utilization of losses prior to their expiration. In applying this ordering rule, further guidance is needed on how to allocate pre-2018 NOLs among separate unrelated trades or businesses.

In establishing guidance and a method for allocating pre-2018 NOLs, we recommend the final regulations provide an exempt organization the flexibility to specify its own allocation in order to maximize the NOL deduction in any given tax year. Specifically, we recommend the final regulations allow for an allocation of pre-2018 NOLs among separate silos that results in maximum utilization of the NOLs in the current tax year.

Example:

Exempt organization X is a calendar year corporation with two unrelated trades or businesses (LOB A and LOB B):

X has a pre-2018 NOL carryforward equal to $5,000
LOB A has a post-2017 NOL carryforward equal to $1,200
LOB B has a post-2017 NOL carryforward equal to $100
2019 UBTI before NOL deduction:
LOB A - $4,500
LOB B - $2,000

X's combined 2019 UBTI before NOL deduction is equal to $6,500. After applying the pre-2018 NOLs, in accordance with the ordering rule as provided in the Proposed Regulations, X has $1,500 of UBTI.

Under the Council recommendation, the allocation of pre-2018 and post-2017 NOLs is as follows:

Apply Pre-2018 NOLs

LOB A – $3,100 of pre-2018 NOL utilized resulting in $1,400 UBTI before applying post-2017 siloed NOL.
LOB B – $1,900 of pre-2018 NOL utilized resulting in $100 UBTI before applying post-2017 siloed NOL.

Apply Pst-2017 NOLs

Accordingly, the post-2017 NOLs are then applied to each of their respective silos, resulting in aggregate UBTI of $200:

LOB A – $1,400 less $1,200 post-2017 NOL resulting in siloed UBTI of $200. Post-2017 NOL is fully utilized.
LOB B - $100 less $100 post-2017 NOL utilized resulting in siloed UBTI of $0. Post-2017 NOL is fully utilized.
Aggregate UBTI for 2019 is $200.

We do not recommend adopting a rule that would require organizations to allocate the pre-2018 NOL among silos based on a ratio of siloed UBTI to total UBTI before NOL deductions. Imposing this requirement would be add administrative burden to organizations and be contrary to Congress's intent to add flexibility and provide relief with respect to NOLs during the economic downturn caused by COVID-19.

Further, as established in previous comments submitted on August 17, 2018, we request guidance on the treatment of accumulated unused losses from prior years upon the sale, exchange, liquidation or dissolution of a trade or business. We recommend that such an event result in the use of accumulated losses from prior years, applied first to any gain realized on the disposition of the trade or business and any remaining accumulated losses made available as an offset to UBTI from other trades or businesses of the organization.

Finally, with respect to the ordering rules, as established by the proposed regulations, we request that the presentation in the Form 990-T be modified to more clearly reflect the use of pre-2018 NOLs before the use of post-2017 NOLs. The current form provides for the use of post-2017 NOLs first, on page 1 of the 990-T, and then pre-2018 NOLs next, on page 2 of the 990-T. Until the form can be modified, we request that the Instructions to Form 990-T provide additional guidance on how such ordering rules should be applied in completing the Form 990-T.

B. CARES Act Modifications

In the case of a taxable year beginning after December 31, 2020, Section 172(a), as modified by the CARES Act, provides for an NOL deduction that is the sum of pre-2018 NOLs and the lesser of:

- post-2017 NOLs, or
- 80% of taxable income computed without regard to certain deductions but reduced by pre-2018 NOLs.

Thus, the 80% limit is applied to taxable income net of pre-2018 NOLs.

As Section 512(b)(6) permits an NOL deduction, as computed under Section 172, in computing UBTI, further guidance is needed on how to apply the 80% limitation in the context of section 512(a)(6). Specifically, guidance is required as to whether such limitation should be based on aggregate UBTI reduced by pre-2018 NOLs or the UBTI of each respective silo reduced by pre-2018 NOLs.

In considering the intent of the CARES Act as well as the provisions of section 172, we believe that all 2018, 2019, and 2020 losses arising from an exempt organization's unrelated trades or businesses should be eligible for carryback to any pre-2020 unrelated trade or business, including suspended losses due to the siloing rules under section 512(a)(6). This position is consistent with Section 172(e) in that Section 512(a)(6) "siloing" was not in effect for years prior to 2018. In addition, Section 512(a)(6) imposes NOL deduction limits in post-2017 tax years but does not impose limitations on the NOLs themselves, including the ability to carry back and carry forward as allowed under Section 172. Furthermore, the Congressional intent to offer expedited liberal economic relief supports a broad application of NOL carrybacks arising from 2018, 2019, and 2020 tax years.

The following examples compare potential interpretations to illustrate that this recommendation offers the best flexibility to organizations affected by COVID-19.

Example 1:

Exempt organization X is a calendar year corporation with two unrelated trades or businesses (LOB A and LOB B):

X has a pre-2018 NOL carryforward equal to $5,000
LOB A has a post-2017 NOL carryforward equal to $1,200
LOB B has a post-2017 NOL carryforward equal to $100
2021 UBTI before NOL deduction:
    LOB A - $4,500
    LOB B - $2,000

Applying the ordering rules under section 172(a)(2), aggregate UBTI of $6,500 is first reduced by the $5,000 pre-2018 NOL, leaving $1,500 in UBTI. Here are three possible outcomes:

SCENARIO 1

	Allocation based on maximum NOL use		
	Silo 1	Silo 2	Total
2019 UBTI before NOLD	4,500	2,000	6,500
Pre-2018 NOL	(3,000)	(2,000)	(5,000)
Remaining UBTI	1,500	-	1,500
Post-2017 NOL (limited to 80% of UBTI)	(1,200)	-	(1,200)
	300	-	300

Under Scenario 1, the pre-2018 NOL is allocated for maximum NOL deduction; and the 80% limit is the same whether applied to the $1,500 in aggregate UBTI or siloed UBTI.

SCENARIO 2

	Allocation based on siloed UBTI and 80% aggregate UBTI before NOLD		
	Silo 1	Silo 2	Total
2019 UBTI before NOLD	4,500	2,000	6,500
Pre-2018 NOL	(3,462)	(1,538)	(5,000)
Remaining UBTI	1,038	462	1,500
Post-2017 NOL (limited to 80% of UBTI)	(1,038)	(100)	(1,138)
	0	362	362

Under Scenario 2, the pre-2018 NOL is allocated to the silos based on a ratio of siloed UBTI to total UBTI before taking into account any NOL deductions. Aggregate UBTI, reduced by the pre-2018 NOL, is used to apply the 80% limit.

	SCENARIO 3 Allocation based on siloed UBTI		
	Silo 1	Silo 2	Total
2019 UBTI before NOLD	4,500	2,000	6,500
Pre-2018 NOL	(3,462)	(1,538)	(5,000)
Remaining UBTI	1,038	462	1,500
Post-2017 NOL (limited to 80% of UBTI)	(831)	(100)	(931)
	208	362	569

Under Scenario 3, the pre-2018 NOL is allocated to the silos based on a ratio of siloed UBTI to total UBTI before taking into account any NOL deductions. Siloed UBTI, reduced by the pre-2018 NOL, is used to apply the 80% limit.

Example 2:

Exempt organization X is a calendar year corporation with two unrelated trades or businesses (LOB A and LOB B):

X has a pre-2018 NOL carryforward equal to $0
LOB A has a post-2017 NOL carryforward equal to $1,200
LOB B has a post-2017 NOL carryforward equal to $100
2021 UBTI before NOL deduction:
LOB A - $1,400
LOB B - $2,000

Since there is no pre-2018 NOL, neither aggregate nor siloed UBTI is reduced before computing the 80% limitation.

If the 80% limitation applies to siloed UBTI, then post-2017 NOLs are used as follows:

LOB A - $1,120 ($1,400 x 80%) of post-2017 NOL utilized resulting in UBTI of $280 ($1,400 less $1,120).
LOB B - $100 ($2,000 x 80% = $1,600 limited to $100 available) of post-2017 NOL utilized resulting in UBTI of $1,900 ($2,000 less $100).
Aggregate UBTI after NOL deduction is $2,180 with total NOL usage of $1,220. LOB A carries forward a $280 NOL to 2022.

Alternatively, if the 80% limitation applies to aggregate UBTI then post-2017 NOLs are used as follows:

80% limitation based on $3,400 aggregate UBTI equals $2,720.
LOB A - $1,200 of post-2017 NOL utilized resulting in UBTI of $200 ($1,400 less $1,200)
LOB B - $100 of post-2017 NOL utilized resulting in UBTI of $1,900 ($2,000 less $100).
Aggregate UBTI after NOL deduction is $2,100 with total NOL use of $1,300 and no carryforward remaining.

The table below depicts a side by side representation of the resulting UBTI in each scenario, for purposes of comparison.

	80% Limitation - Per Silo			**80% Limitation - Aggregate UBTI**		
	LOB A	**LOB B**	**Total**	**LOB A**	**LOB B**	**Total**
2021 UBTI	$1,400	$2,000	$3,400	$1,400	$2,000	$3,400
Post-2017 NOL	(1,120)	(100)	(1,220)	(1,200)	(100)	(1,300)
UBTI	$280	$1,900	$2,180	$200	$1,900	$2,100

X. Public Support Test

The preamble to the Proposed Regulations discusses not imposing the Section 512(a)(6) rules for purposes of calculating the public support tests pursuant to Sections 509(a)(1) and 170(b)(1)(A)(vi) and 509(a)(2). Although we agree that a change in the calculation of unrelated business income under Section 512(a)(6) potentially creates a higher threshold to meet either public support test, the proposal essentially requires nonprofits to perform two different sets of calculations which could be an administrative burden. Similar to the way in which organizations can currently move back and forth between the two public support tests, we recommend that an organization should be able to make the public support test calculation by either taking into account the Section 512(a)(6) rules and limiting their administrative burden, or recalculating

unrelated business activities as if the Section 512(a)(6) rules do not apply for all relevant years of the public support test. [10]

[10] IRS and Treasury should take care to ensure that consideration of the changes to the public support test have met adequate notice and comment requirements as some organizations may not have realized that the regulations under section 512(a)(6) may have impacted the public support test.

Exhibit 1

TEGE Exempt Organization Council
Comments in Response to Notice 2018-67

January 14, 2019

This document responds to the request for comments in Notice 2018-67 and reflects feedback from individuals participating in the TEGE Exempt Organizations Council (the "Council" or "TEGE Council").

The TEGE Council was formed to (i) open and maintain lines of communication between the Tax Exempt & Government Entities Division (the "Division") of the IRS and the practitioner community, (ii) provide the Division with the thinking of the practitioner community on procedural and systemic matters, (iii) provide practitioners a forum to share their concerns with the IRS regarding both policies and specific tax issues and procedures, (iv) educate the practitioner community and the exempt organizations community.

The Council's members and participants include attorneys, certified public accountants, and other practitioners and professionals in the exempt organizations community (including in-house practitioners and professionals). The comments below do not necessarily represent the views of the Internal Revenue Service (the "Service or "IRS"), Treasury, the TEGE Exempt Organizations Council, or any particular Council member. The preparers of these comments were not engaged by any client for the purpose of submitting these comments or otherwise to influence the development or outcome of regulatory guidance.

In Notice 2018-67, the IRS and Treasury requested comments regarding how to identify separate unrelated trades or businesses, for purposes of Section 512(a)(6) of the Internal Revenue Code ("IRC"). In particular, the Service and Treasury requested comments as to the following issues:

1. Where and how IRC Sections 132, 162, 183, 414, and 469, and the regulations thereunder, may aid in determining how to identify an exempt organization's separate trades or businesses for purposes of Section 512(a)(6);

2. Whether using fewer than 6 digits of the NAICS codes, or combining NAICS codes with other criteria, would appropriately identify separate trades or businesses for purposes of achieving the objective of Section 512(a)(6);

3. How to treat income that is not from a partnership or a regularly carried on trade or business, but that is included in unrelated business taxable income ("UBTI") under Sections 512(b)(4), (13), or (17), for purposes of Section 512(a)(6); and

4. The scope of activities, both investment partnership interests or other activities in the nature of an investment that may generate unrelated business income, that should be included in the category of "investment activities" for purposes of Section 512(a)(6).

We will address each of these areas in our comments.

I. Use of Criteria from Other Code Sections in Identifying Separate Trades or Businesses

In comments dated August 13, 2018, members of the TEGE Council proposed that exempt organizations should be able to identify separate trades or businesses, and group similar activities as a single trade or business, for purposes of Section 512(a)(6), based on a number of factors, including:

(i) Causal connection to UBTI—i.e., the degree to which the activity contributes importantly to the generation of the revenue or loss. Would the revenue or loss have occurred but for the activity?

(ii) Management structure—i.e., the extent of common control over the activity by the same persons pursuant to the same policies and procedures;

(iii) Geographic location where activities are carried out; and

(iv) Interdependencies between or among the activities, for example, the extent to which the activities:

(a) involve the same products or services,

(b) involve products or services that are customarily provided together,

(c) are provided to the same customers,

(d) are conducted by the same individuals,

(e) involve common planning and coordination, or

(f) are treated as a single unit or category for accounting and reporting purposes.

In articulating these factors, the TEGE Council members drew from analogous IRC sections (e.g., 183, 469) and related regulations that set forth factors taxpayers should use in grouping similar activities as a single trade or business activity, for purposes of those sections.[1]

For instance, Treas. Reg. §1.469-4(c) provides that one or more trade or business activities or rental activities may be treated as a single trade or business activity, for purposes of determining passive activity gains or losses, if they constitute an appropriate economic unit, depending upon all the relevant facts and circumstances. A taxpayer may use any reasonable method of applying the relevant facts and circumstances in group activities. This regulation provides that the following factors are given the greatest weight in determining whether activities constitute an appropriate economic unit:

- Similarities and differences in types of trades or businesses

[1] See also Treas. Reg. §1.446-1(d), which articulates a general standard for identifying and accounting for separate trades or businesses, for accounting method purposes.

- The extent of common control
- The extent of common ownership
- Geographical location
- Interdependencies between or among the activities; for example, the extent to which the activities:
    - Purchase or sell goods between or among themselves
    - Involve products or services that are normally provided together
    - Have the same customers
    - Have the same employees
    - Are accounted for with a single set of books and records

Similarly, Treas. Reg. §1.183-1(d)(1) provides that multiple undertakings may constitute a single activity, for purposes of determining whether an activity is engaged in for profit, based on all facts and circumstances. Generally, the most significant facts and circumstances in making this determination are:

- The degree of organizational and economic interrelationship of various undertakings
- The business purpose which is (or might be) served by carrying on the various undertakings separately or together in a trade or business
- The similarity of various undertakings

Treas. Reg. §1.183-1(d)(1) notes that the Commissioner will generally accept the characterization by the taxpayer of several undertakings either as a single activity or as separate activities. The taxpayer's characterization will not be accepted, however, when it appears that his characterization is artificial and cannot be reasonably supported under the facts and circumstances of the case.

Sections 183 and 469, like Section 512(a)(6), limit the use of losses from one activity to offset gains from another activity or activities. The regulations under Sections 183 and 469 address the same issue raised by Section 512(a)(6): how to identify separate trade or business activities and group similar activities together into a single trade or business activity. The Section 183 and 469 regulations set forth general, administrable standards that at once establish guardrails for identifying trade or business activities and provide taxpayers with flexibility to reasonably group similar activities as a single trade or business within those guardrails. In adopting these regulations, the IRS and Treasury recognized that such a flexible standard has greater administrability and long-term viability than a narrower, more mechanical definition that would need to be amended from time to time to accommodate ever-evolving and expanding types of trade or business activity.

There is ample precedent for adopting general tax characterization standards within the UBTI realm. Numerous sections of the Code and regulations that govern unrelated trade or business activity require exempt organizations to apply general standards, using a facts and circumstances analysis, in characterizing different trade and business activities:

- Determining whether trades and businesses are substantially related or unrelated, for purposes of determining UBTI under Section 513(a);

- Determining whether and to what extent the use of debt-financed property substantially furthers tax-exempt purposes, to determine whether income from debt-financed property is UBTI under Section 514(b)(A)(A); and

- Determining whether more than an insubstantial amount of trade or business activity is unrelated, for purposes of determining tax exemption under Treas. Reg. §1.501(c)(3)-1(c)(1)

Although it can be challenging at times to make characterizations under these UBTI standards, the exempt community and the IRS have done so for decades, demonstrating that general UBTI standards are administrable for both the IRS and taxpayers.

Accordingly, rather than impose a narrow mechanical framework (e.g., NAICS codes) that inevitably will not accommodate all trades or businesses and will result in inconsistent and inaccurate characterization and reporting (as described in the following section of these comments), it would be more consistent with existing UBTI law and closely analogous sections of the Code and regulations (e.g., 183, 469) to set forth a general standard, using general criteria, for how to group similar activities into a single trade or business for purposes of Section 512(a)(6). This approach would provide needed flexibility for exempt organizations to make reasonable characterizations of the diverse and ever-expanding array of trade or business activities that they engage in. It would also enable organizations to group existing activities consistently with how they already group them for different accounting and reporting purposes.

To assist taxpayers in grouping similar activities into separate trades or businesses, we encourage the IRS and Treasury to include in Section 512(a)(6) regulations and/or other guidance the specific (or similar) examples set forth in the comments of the TEGE Council members on August 17, 2018. These examples could provide safe harbors for, and promote consistency in, organizations' grouping of similar activities into single trades or businesses, for purposes of Section 512(a)(6).

II. Use of NAICS Codes in Identifying Separate Trades or Businesses

A. NAICS Codes Do Not Reliably Identify Separate Trades or Businesses

In Notice 2018-67, Treasury and the IRS state that they "are considering the use of North American Industry Classification System ("NAICS") codes" in determining separate trades or businesses under Section 512(a)(6). The Notice indicates that, pending issuance of proposed regulations, Treasury and the IRS will consider the use of six-digit NAICS codes in determining whether an exempt organization has more than one separate trade or business to be a reasonable, good-faith interpretation of Section 512(a)(6). The Notice asks for comments regarding the utility of using NAICS codes, and whether using fewer than six digits of the NAICS codes, or combining NAICS codes with other criteria, would appropriately identify separate trades or businesses for purposes of Section 512(a)(6).

As described above, and in the August 17, 2018 comments submitted by TEGE Council members, it is essential for exempt organizations to have the option to utilize a more general standard rather than be required to use a more limited, mechanical framework such as NAICS codes for characterizing activities as unrelated trades or businesses under Section 512(a)(6). The use of NAICS codes may have utility in a facts and circumstances analysis under this general standard as a safe harbor for, and/or as a factor to be used in, characterizing separate, unrelated trades or businesses. However, they should not be adopted as the exclusive means to identify and classify separate trades or businesses, for the following reasons:

As the Notice indicates, exempt organizations already use NAICS codes to describe their activities on Form 990-T, though they do so for descriptive reporting purposes, not for purposes of making characterizations that affect their tax liability. Although the IRS uses NAICS codes (generally at the two-digit level) to report unrelated business income tax figures in its Statistics of Income series, the IRS has shown greater aversion to—rather than utilization of--codes to categorize exempt organizations' activities in recent years, having recognized their limitations. In particular, the IRS has eliminated reporting of activity codes on Form 1023. It has also changed course and not required filers to report National Taxonomy of Exempt Entity ("NTEE") codes on Form 990, Part III, because:

(1) The IRS didn't control the codes (the Urban Institute controlled them), and therefore lacked the flexibility to change these codes to further its purposes and meet its needs.

(2) NTEE codes were designed to identify purposes of organizations, not their specific activities.

(3) It is challenging to match a single NTEE code with an organization's primary activity. Because NTEE codes were designed by and for researchers, they make distinctions unrelated to tax purposes and fail to make distinctions relevant for tax purposes, while failing to identify specific activities of concern to the IRS.

Similarly, the IRS does not control NAICS codes, which were developed by the Office of Management and Budget and are maintained by the U.S. Census Bureau. The website of the U.S. Census Bureau (https://www.census.gov/eos/www/naics/faqs/faqs.html) explains that NAICS is designed to group businesses into industries according to similarities in the processes used to

produce goods or services, and is used by Federal statistical agencies in classifying business establishments for the collection, tabulation, presentation, and analysis of statistical data describing the U.S. economy. Note that the codes were not designed, and are not maintained, for tax classification purposes.

Likewise, it is often challenging to match a single NAICS code to a particular unrelated trade or business. An activity may fit into different NAICS codes, depending on the type of transaction such as retail, rental or service income. While it would be reasonable to consider an activity as a single trade or business if it were operated in one location under one name, using the same staff, and same equipment, using the methodology of NAICS system could lead to different treatments.

Similarly, an exempt organization may bundle various services together in a single trade or business. Requiring the organization to un-package the bundle, for purposes of characterizing parts of that activity according to NAICS industry designations, would be administratively burdensome and would unfairly disadvantage exempt organizations in relation to for-profit organizations, which report the same bundled activity as a singular trade or business on their tax returns. The following examples illustrate this problem:

Example 1. A museum provides catering services, valet parking and personal property rentals for its special events clients, which include wedding parties, area businesses, etc. The museum has a special events manager who manages and oversees the special events. The special events manager coordinates staffing needs for the special events with internal departments as well as external vendors.

If required to use NAICS codes, the museum would need to look for four different NAICS codes to report the income as income from four trades or businesses: catering, parking, rental of real property, and personal property rentals. The museum would also have to unbundle all the package offerings to segregate income from each event; and would have to allocate personnel costs, depreciation, utilities, and other expenses against the bundled activities.

However, if allowed to use a more general standard and a facts and circumstances analysis, the museum could note the NAICS codes as one factor to consider in reporting the income from the special events activity. The museum could then consider other factors such as the interdependence and the common control of the activity by the same persons in determining that the special events activity is one trade or business. In this situation, it would be less of an administrative burden on the museum to track revenue and expenses from the special events activity as one trade or business, rather than having to treat the special events activity as four different trades or businesses for Form 990-T reporting purposes.

This would put the museum in an equivalent position for tax reporting purposes as its neighboring for-profit conference center that also provides the same bundled services to wedding parties and area businesses.

Example 2. In Example 1, if the museum were to provide its parking facilities to the public (outside of the special events activities at which it operates those facilities primarily for the convenience of museum patrons), the museum would again need to apply the general standard and analyze the facts and circumstances to determine how to report the parking revenue. In this

scenario, the museum may very well provide parking in a different manner than it does during special events.

For example, the museum may lease its lot to a third party vendor in this example; no valet service may be offered; no security may be provided, etc. In this case, it may be appropriate for the museum to report the parking revenue separately from the parking revenue generated by the special events activity in determining Form 990-T reporting requirements.

Example 3. A nonprofit hospital operates a maternity store in the hospital that sells and rents medical equipment such as breast pumps or other medical equipment to both patients and non-patients. Although the hospital operates this store as a single trade or business, retail sales of this type could fall under NAICS code 4461 (Health and Personal Care Stores) or 4539 (Other Miscellaneous Store Retailers) within NAICS code 44-45 (Retail Trade), while the equipment rental could potentially fall under NAICS code 5322 (Consumer Goods Rental) within NAICS code 53 (Real Estate and Rental and Leasing).

Example 4. A nonprofit physician dermatology clinic provides spa services and sells personal care items (lotions, skin care products, etc.). In any given year the majority of sales to non-patients generating UBTI could be from either the spa services or retail sales. Although the clinic comprises a single trade or business, utilizing the NAICS methodology could lead to characterizing the clinic operations as two separate trades or business, possibly under NAICS code 8121 (Personal Care Services) within NAICS code 81 (Other Services) and 4461 (Health and Personal Care Stores) or 4539 (Other Miscellaneous Store Retailers) within NAICS code 44-45 (Retail Trade).

Although the examples above demonstrate how NAICS codes can be too particular to reflect an actual trade or business, some NAICS codes may be too broad to characterize a single trade or business, as they may describe more than one trade or business.[2] In those cases, exempt organizations may be incentivized to combine activities that they would normally treat as separate trades or businesses into a single trade or business, for purposes of limiting liability under Section 512(a)(6).

Attempting to fit a round peg trade or business into a square hole NAICS code, as in the examples above, would require a burdensome, fact-intensive analysis, and result in inconsistent characterization[3] and reporting by organizations that engage in similar trades or businesses that

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[2] The IRS acknowledges in prior year and draft 2018 Form 990-T instructions that most of the 6-digit NAICS codes describe more than one type of activity:

- **Business Activity Codes**

  "….Note that most codes describe more than one type of activity. Avoid using codes that describe the organization rather than the income-producing activity."

[3] The government has acknowledged inconsistencies in the classification of activities using NAICS codes. For instance, a recent Treasury Inspector General for Tax Administration (TIGTA) report determined that the NAICS codes are unreliable for use in identifying businesses that may be subject to excise tax reporting and payment. See TIGTA, Ref. No. 2014-43-043, *The Affordable Care Act: An Improved Strategy is Needed to Ensure Accurate Reporting and Payment of the Medical Device Excise Tax* (July 2014). In particular, TIGTA found that use of NAICS codes did not accurately identify businesses engaged in the sale of medical devices. It indicated in the report that 958 of 2,965 businesses that filed a Form 4720 to report the medical device excise tax classified that sales activity using

integrate multiple activities. Accordingly, it would be more administrable and less burdensome for exempt organizations to have the option to use the more general standard described above in identifying and reporting separate trades or businesses, for Section 512(a)(6) purposes.

B. Use of Two-Digit NAICS Codes Would Be More Administrable Than Use of Longer Codes

If Treasury and the IRS were to utilize NAICS codes to identify separate trades or businesses, for Section 512(a)(6) purposes, the two-digit NAICS codes would be more feasible to use than longer NAICS codes. As discussed above, while we do not recommend that NAICS codes be the exclusive means of identifying separate trades or businesses, the use of two-digit codes may be helpful as a safe harbor for smaller organizations or as a factor a larger organization may use to identify separate trades or businesses. We do not recommend the use of NAICS codes longer than two digits under any circumstances.

There are over 1,000 six-digit NAICS codes, and they are far too narrow to be used to define separate trades or businesses. As illustrated both in the examples above and below, use of these six-digit codes would cause inconsistent reporting of UBTI within the exempt organization community, increase tax risks unnecessarily, and possibly lead to perceived abuse.

One reason that NAICS codes with two digits would be preferable for delineating trades or businesses for Section 512(a)(6) purposes is that longer NAICS codes often reflect components of a single trade or business, but not the entire business. For instance, six-digit NAICS codes are intended to classify each physical location where business is conducted (for example, each factory, hotel, mine, or central administrative office) based on the "primary business activity" conducted at that location, often determined by revenue. Thus, a six-digit NAICS code assigned to a business location does not attempt to encompass all of the activities conducted at that location, even if all of those activities are conducted as single trade or business. This is evident from the following examples:

- The two-digit NAICS code 72 encompasses Accommodation and Food Services. The three-digit code 722 encompasses food services and drinking places. (The only other three-digit code under 72 is 721, which is for Accommodation.) The three-digit code 722 includes, among others: caterers (722320); mobile food services (722330); full-service restaurants (722511); limited-service restaurants (722513); cafeterias, grill buffets, and buffets (722514); and snack bars (722515). A single food service establishment at a cultural or educational institution might fall within all six of these categories at different times using the same kitchen and staff. If any of the food activities are unrelated to exempt purposes,

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code 339110 (Medical Equipment and Supplies Manufacturing), while 2,007 of those businesses used various other codes to identify the sale of medical devices, including 454390 (Other Direct Selling Establishments) and 423990 (Other Miscellaneous Durable Goods).

A prior TIGTA report on the excise tax on indoor tanning services also concluded that NAICS codes reported on tax returns for indoor tanning services activities were not consistent, and could not be relied upon as being correct. See TIGTA, Ref. No. 2011-40-115, *The Affordable Care Act: The Number of Taxpayers Filing Tanning Excise Tax Returns is Lower Than Expected* (Sept. 2011).

they should all be treated as the same trade or business. In this case, 722 is the largest code that could be used, while the two-digit code 72 would more accurately reflect the trade or business as a whole.

- The two-digit NAICS code 54, professional, scientific, and technical services, has only one three-digit code – 541 – also named professional, scientific, and technical services. However, 541 includes 49 distinct six-digit codes. Research, for example, is broken into: research and development in nanotechnology (541713); research and development in biotechnology, except nanobiotechnology (541714); research and development in the physical, engineering, and life sciences (except nanotechnology and biotechnology) (541715); and research and development in the social sciences and humanities (541720). Some or all of these might be conducted on an undifferentiated basis in an exempt organization's laboratory as a single unrelated trade or business.

In these examples, a six-digit NAICS code would not cover all similar activities performed by the same people using the same facilities. An establishment that was primarily a cafeteria (722514) could be classified as such regardless of its catering services without adverse consequences. A trade or business definition under Section 512(a)(6), on the other hand, needs to account for each unrelated trade or business as a whole, so a broader (fewer digits) classification would be more compatible with actual exempt organization trades or businesses.

Even two-digit codes include some ambiguities. For example, case law and IRS rulings indicate that providing certain commercially available administrative or management services for unrelated organizations, even if the recipients are tax-exempt, is an activity that may be unrelated to exempt purposes. Management services could be described by two or more different NAICS two-digit codes. Under the two-digit code 54, they might fall into the four-digit group 5412 (accounting, tax preparation, bookkeeping, and payroll services) or the four-digit group 5416 (management, scientific, and technical consulting services). On the other hand, the introductory description of the two-digit code 54 states: "This sector excludes establishments primarily engaged in providing a range of day-to-day office administrative services, such as financial planning, billing and recordkeeping, personnel supply, and physical distribution and logistics. These establishments are classified in Sector 56, Administrative and Support and Waste Management and Remediation Services." Thus, a reporting exempt organization would need to make a judgment whether the management services it provides fall under 54 or 56 (or perhaps yet another two-digit code).

Despite these ambiguities, using a two-digit classification safe harbor would simplify classification and reporting by exempt organizations (if they were required to use NAICS codes for purposes of Section 512(a)(6)), because they would not need to determine which six-digit code is most applicable or whether two or more codes are applicable. Instead, the exempt organization could locate a classification (whether at level 2, 3, 6, or anywhere in between), then determine the two-digit classification within which the activity belongs. For example, it is not readily evident that advertising activities are included in the two-digit code 54, "Professional, Scientific, and Technical Services." However, a quick keyword search for "advertising" on the U.S. Census Bureau's NAICS site leads to the four-digit code 5418, "Advertising, Public Relations, and Related Services," which is part of the 54 two-digit code.

The following examples illustrate the preferability of using 2-digit NAICS codes as a factor and/or safe harbor in identifying separate trades or businesses, for purposes of Section 512(a)(6), rather than using longer NAICS codes.

Example 1. Overlapping Codes for the Same Activity. A college uses the NAICS six-digit codes to report as separate businesses the UBTI rental of its facilities to third parties for the use of its facilities. The three tenants include: (1) commercial businesses located on the first floor of a building on the edge of campus, (2) members of the general public who stay at the executive education center for basketball games and (3) those few donors and guests who may stay overnight at the luxurious suites in the student union. The school earns a moderate profit on the commercial tenants but derives significant losses on the other two activities.

When reviewing these codes for 'rent' under keyword search tool, NAICS lists 43 codes. Of these codes, it appears that these rental activities may be grouped as one separate business, "lessors of nonresidential buildings (except mini-warehouses)." Accordingly, the exempt entity would report on Form 990-T a loss for these activities and pay no taxes.

However, if the term "hotel" were used in the key search tool rather than "rent," the search would broaden to include hotels as well as lessors of nonresidential buildings (except warehouses). Arguably, in this case, the rentals from the executive education center may be classified as a hotel and possibly the student union, whereas the commercial businesses would most likely continue to be classified as a nonresidential building. Accordingly, the exempt entity would report on its tax return a taxable loss under the first scenario and a taxable gain under the second scenario, resulting in taxes paid to the IRS.

Different word searches may lead to different reporting by various exempt entities for the same activities, resulting in some entities paying taxes whereas others may not. Further, the tax risk of the IRS re-classifying these activities and re-calculating UBTI would increase unnecessarily. Additionally, NAICS updates these codes every five years to reflect the changing economies with "one goal - to modify or create industries to reflect new, emerging, or changing activities and technologies" (page 13 of the NAICS manual). Said differently, continual modification of these codes would add further complexity to reporting these activities, possibly resulting in forfeited losses for any re-classified activity.

Example 2. An Activity that Includes Multiple Codes. A pharmaceutical company hires a medical school to review its research protocol developed for specimens related to various biotechnologies, including nanotechnology, by testing certain specimens in its laboratories over a three-year period. The principal investigator (PI) with the medical school will also serve as a consultant on improving the company's process and implementing recommended practices. The payment is a fixed fee provided in a single contract.

The issues are whether and how the medical school should classify the contract as multiple trades or businesses, for Section 512(a)(6) purposes, and, if more than one trade or business, how should it allocate its revenues and corresponding expenses derived from these services accordingly. Possible applicable codes include the following, among others:

- 541714 - biotechnology research and development laboratories or services in the medical sciences (except nanobiotechnology research and development) is described primarily as involving the study of the use of microorganisms and cellular and biomolecular processes to develop or alter living or non-living materials.

- 541713 - research and development in nanobiotechnology is described as the study of matter at the nanoscale.

- 541614 – medical laboratories is described primarily as providing analytic or diagnostic services, including body fluid analysis, generally to the medical profession or to the patient on referral from a health practitioner.

- 541613 – marketing consulting services is described primarily as customer services management consulting services.

In one scenario, the school may treat the contract as a single separate trade or business using the code for the research of biotechnology (541714) because it is the lead service with the others being ancillary and incidental to the contract as a whole. Or, in another scenario, it may argue that the default code is "marketing consulting services" since the other codes describe activities that, on their face, appear to be substantially related to its tax-exempt purposes and do not derive UBTI.

Alternatively, in a third scenario, the school may treat the contract as having four separate trades or businesses, raising the question of how to allocate the revenues and expenses with a fixed fee provided in the contract. A market comparison may not be not readily available, at least for the first three services, given their complexity and uniqueness. Likewise, the expense allocations may result in multiple allocations for the use of the same facility. For instance, in addition to the traditional allocation of dual use facilities between exempt and taxable activities, i.e. revenues derived from its core research mission and the first taxable activity, additional allocations may then be necessary for the second and third taxable activities, all of which are performed in the same research laboratory.

Given the possible use of multiple codes for the same unrelated trade or business activity/activities, various classifications based on reasonable, good faith interpretations are highly probable, each possibly resulting in different tax liabilities for different exempt organizations under Section 512(a)(6).

As in Example 1, above, the tax risks increase unnecessarily should the IRS disagree with any position taken. Note that the ground upon which the IRS may challenge these six-digit codes would generally be based on a brief factual description of the activity provided by NAICS codes rather than a more complete explanation of how the activity is conducted, possibly misconstruing the essence of the transaction and its purpose.

With widespread inconsistency and higher tax risks, any allocation of revenues and expenses that consistently derive losses, based on the use of these multiple codes, may inadvertently give the impression that exempt entities may be managing the codes to their financial advantage.

Example 3. Code Differs Depending on Perspective. An activity may fit into a number of different six-digit NAICS codes depending on who performs it, where it is performed, for whom it is performed, and for what purpose it is performed. Take the example of a tax-exempt nursing home whose physician medical director consults with a medical device manufacturer on better user interfaces on hospital beds for seniors with limited mobility or sight. The draft instructions for the Form 990-T admonish us to avoid using codes that describe the organization rather than the income-producing activity. Thus, codes describing the nursing home (623110 – Nursing Care Facilities, 623311 – Continuing Care Retirement Communities, or 623312 – Assisted Living Facilities for the Elderly) would not be apposite. However, eight six-digit codes could describe the activity, depending on perspective:

- 339112 Surgical and Medical Instrument Manufacturing
- 334118 Computer Terminal and Other Computer Peripheral Equipment Manufacturing
- 334310 Audio and Video Equipment Manufacturing
- 335210 Small Electrical Appliance Manufacturing
- 337127 Institutional Furniture Manufacturing
- 541690 Other Scientific and Technical Consulting Services
- 541715 Research and Development in the Physical, Engineering, and Life Sciences (except Nanotechnology and Biotechnology)
- 541990 All Other Professional, Scientific, and Technical Services

The ability to use two-digit NAICS codes for a safe harbor and/or as a factor in determining a trade or business, for purposes of Section 512(a)(6), would simplify the analysis – the activity likely would fall into either code 33 or 54. The ability to use two-digit NAICS codes also would focus the analysis on the nature of the activity – is it manufacturing (33) or professional, technical, and scientific services (54)? Because the exempt organization is not actually engaged in manufacturing, NAICS code 54 is likely the better trade or business category. Because finding the most appropriate two-digit code could be a burdensome and frustrating process for certain exempt organizations and their trades or businesses, we would oppose making two-digit NAICS codes the exclusive means of identifying a trade or business. Nevertheless, two-digit NAICS codes are far less burdensome than trying to identify a longer NAICS code.

The Section 132 regulations provide a precedent for using two-digit codes as a factor (but not the exclusive factor) in classifying business activities. In particular, Treas. Reg. §1.132-4(a)(2)-(3) define an employer's line of business, for purposes of the line of business limitations for no-additional cost services and qualified employee discounts, by referencing the codes contained in the Enterprise Standard Industrial Classification Manual (ESIC). The ESIC, the precursor to the NAICS, used two-digit codes to classify certain business activities, including general retail merchandise stores, hotels and other lodging places, and food stores. Treas. Reg. §1.132-4(a)(2)

provides that an employer is considered to have more than one line of business if it offers for sale property or services in more than one two-digit ESIC code.

Note that although the Section 132 regulations require consideration of the two-digit codes in determining a line of business, they do not preclude two different activities that could be described by different two-digit codes from being aggregated as a single business, based on a facts and circumstances approach.[4] A similar approach, in which exempt organizations consider two-digit NAICS codes along with other factors set forth elsewhere in the Code and regulations (e.g., 132, 183, 469) to classify their unrelated trade or business activities, would provide a flexible, administrable standard that would enable organizations to reasonably classify complex, ever-evolving business activities, for purposes of Section 512(a)(6).

[4] Treas. Reg. §1.132-4(a)(3) permits aggregation of separate activities into a single line of business if certain factors are met, including (i) it is uncommon in the industry for an employer to perform one line of business without the other(s), (ii) it is common for a substantial number of employees to perform substantial services for more than one line of business for the same employer, and (3) multiple lines of business of an employer conducted on the same premises would normally be considered a single line of business if conducted together in a single store.

III. Characterization of Income Deemed UBTI, But Not Generated from an Unrelated Trade or Business, for Purposes of Section 512(a)(6)

In the comments dated August 13, 2018, members of the TEGE Council proposed that an exempt organization should be able to aggregate gross UBTI and losses for purposes of calculating net UBTI under Section 512(a)(6) from activities that do not meet the Section 513(c) definition of "trade or business," but rather are statutorily deemed to be UBTI such as:

- Receiving interest, rents, royalties, and annuities from controlled entities under Section 512(b)(13);
- Paying to provide qualified transportation fringe benefits to employees under Section 512(a)(7);
- Receiving rental income treated as UBTI under Section 512(b)(3)(B);
- Receiving debt-financed income treated as UBTI under Section 512(b)(4);
- Receiving Subpart F insurance income under Section 512(b)(17); and/or
- Receiving partnership income treated as UBTI under Section 512(c).

Treasury and the IRS should allow exempt organizations to aggregate income and losses from such categories of UBTI because Section 512(a)(6) applies only to unrelated trade or business activities, and the activities listed above are not unrelated trades or business activities. The Code and regulations are clear that unrelated trade or business activities only include the "sale of goods" or the "performance of services" that are unrelated to the organization's mission. See Section 513(c) and Treas. Reg. § 1.513-1(b). The types of income enumerated above are not derived from unrelated trade or businesses activities of the exempt organization; therefore, Section 512(a)(6) should not apply to them.

The justification for the Notice's interim rule that such items are subject to separate computation under Section 512(a)(6) derives from erroneous statutory interpretation. Notice 2018-67, Section 4, provides that

> [t]he Treasury Department and the IRS note that, in the absence of § 512(b)(1), (2), (3), and (5), interest, royalties, rents, and gains (or losses) from the sale, exchange, or other disposition of property would be included in the calculation of UBTI to the extent that such amounts are "gross income derived by any organization from any unrelated trade or business . . . regularly carried on by it" under § 512(a)(1). Accordingly, the Treasury Department and the IRS see no distinction between "gross income derived by any organization from any unrelated trade or business…regularly carried on by it" within the meaning of § 512(a)(1) and amounts included in UBTI "as an item of gross income derived from an unrelated trade or business" under § 512(b)(4), (13), and (17).

This statutory interpretation of Section 512(b) is erroneous because it treats the plain and unambiguous language of Section 513(c) as superfluous or irrelevant. It is not the case that passive

income such as interest, royalties, rents, etc. would be included in the calculation of UBTI in the absence of the modifications set forth in Section 512(b). The statute is more nuanced than that. In the absence of the Section 512(b) modifications, passive income would only be included in the calculation of UBTI *to the extent that* the activity producing the income meets the definition of an unrelated trade or business set forth in Section 513(c), which is limited the *sale of goods or performance of services*. The statute reflects the justifiable concern on the part of Congress that the IRS could interpret the general definition of unrelated trade or business income from the sale of goods or performance of services so expansively as to sweep in passive income as well, which is why Congress provided the modifications in Section 512(b)—to preclude such overly expansive notions of UBTI.

By suggesting the definition of unrelated trade or business activities should be broadened to encompass passive income and the other UBTI items listed above, the Notice opens the door to serious unintended consequences and spillover effects to UBTI jurisprudence, administrability, and tax policy.

To appreciate the need for a nuanced understanding of UBIT as it applies to passive income, consider the 5th Circuit Court of Appeals opinion *Louisiana Credit Union League v. United States, 693 F.2d 525* (5th Cir. 1982) (offering two-part test for determining whether activities of trade association are substantially related). The case involved income that was nominally a "royalty" eligible for exclusion from UBTI under the Section 512(b)(2) modification, but which was, in fact, income from the performance of services unrelated to the association's mission. The court failed to make the distinction between royalties for the right to use intellectual property and fee-for-services income, so, in *dicta*, the opinion used "profit motive" as the sole criterion needed to identify an unrelated trade or business, effectively reading out the "sale of goods or performance of services" from Section 513(c). These *dicta* suggest, erroneously, that passive income, if earned in the right state of mind (i.e., with a profit motive), could be an unrelated trade or business, regardless of whether it derives from the sale of goods or performance of services. These same *dicta* could be used, again erroneously, to support the position set forth in the Notice that the separate computation rules of Section 512(a)(6) apply to passive income.

The "profit motive" interpretation of Section 513(c) in *Louisiana Credit Union League* is mere *dicta* because the case involved UBTI from the performance of marketing services—an active trade or business under Section 513(c), and not, in fact, income from passive sources. It was, therefore, unnecessary for the court to construe Section 513(c) in a divergent manner from the statute and Treasury Regulations. This case was decided in the midst of the development of the body of law that now enables the IRS reliably to distinguish passive royalty income earned by licensing intellectual property from active income earned by the performance of services. See, e.g., Rev. Rul. 81-178, 1981-2 C.B. 135 (distinguishing royalties for the use of a valuable right from payments for personal services). This useful development in regulatory guidance obviates the need for any such tortured statutory interpretation.

Moreover, the 5th Circuit decision is at odds with a subsequent Supreme Court decision in *Commissioner v. Groetzinger*, 480 U.S. 23, 35 (1987), which states:

> Of course, not every income-producing and profit-making endeavor constitutes a trade or business. The income tax law, almost from the beginning, has distinguished

> between a business or trade, on the one hand, and 'transactions entered into for profit but not connected with . . . business or trade,' on the other. See Revenue Act of 1916, section 5(a) Fifth, 39 Stat. 759. Congress 'distinguished the broad range of income or profit producing activities from those satisfying the narrow category of trade or business.' *Whipple v. Commissioner*, 373 U.S. 193, 197 (1963).

It would be ill advised for the IRS and Treasury to rely on the 5th Circuit's pre-*Groetzinger* interpretation of Section 513(c) for purposes of Section 512(a)(6) because if every passive investment activity an exempt organization carries on with the intent to produce income were a trade or business, then every dollar of investment income an exempt organization realizes could, theoretically, be a separate trade or business—an unimaginably complex and unadministrable proposition for which there is no statutory support or tax policy justification.

Finally, it would be anomalous to treat passive investment activity as a trade or business for purposes of UBIT because it is not considered a trade or business for purposes of Section 162 or other purposes of the Code. The tax law draws a critical distinction between profit-seeking trade or business and profit-seeking nonbusiness, the latter composed primarily of investment activities. The *Groetzinger* case (which analyzed whether a professional gambler could deduct his gambling expenses) generally provides that a trade or business is a profit-seeking activity conducted "with continuity and regularity" while nonbusiness investment activities generally lack the taxpayer's continuous or regular attention, despite the taxpayer's intent to earn an economic return.[5] This distinction is important because Section 162 allows taxpayers to deduct costs incurred in connection with a trade or business, but not costs incurred in connection with nonbusiness investment activities. The Treasury Regulations interpreting Section 513(c) cross-reference the definition of trade or business under Section 162. There is, therefore, a risk that treating nonbusiness investment activities as a trade or business for purposes of the separate computation of UBTI under Section 512(a)(6) could fuel taxpayer efforts to deduct investment expenses under Section 162. Moreover, Section 212, which enables individual taxpayers and trusts to deduct certain investment expenses, does not use the words "trade or business" to describe investment activities; rather, it provides that "[i]n the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—(1) *for the production or collection of income*; (2) for the management, conservation, or maintenance of property held for the *production of income*… ." The fact that Congress wrote a separate code section to provide for the deductibility of investment expenses is itself sufficient to establish that Congress does not view such expenses as deductible under Section 162 and, therefore, that investment activity is not within the ambit of a "trade or business" under Section 513(c).

[5] *Commissioner v. Groetzinger*, 480 U.S. 23, 35 (1987).

IV. Consider Investments in Partnership Interests as a Single Trade or Business for Exempt Investors

The exempt organization community invests in partnerships and other vehicles to generate funding that allows it to further its exempt missions, including, in certain cases, assisting the underprivileged, healing the indigent, and educating the less fortunate. As the community has grown, these investments have come to significantly benefit the economy, for instance, one segment of exempt entities, colleges and universities, invested more than $565 billion in businesses in calendar year 2017.[6] Further, over half of these investments are made in alternative investments, defined as nonconventional investments that include private equity, hedge funds, managed futures, real estate, commodities and derivative contracts.[7] Likewise, the Council on Foundations surveyed 143 private foundations and 81 community foundations representing $104.4 billion of endowment assets and found that 43% of the private foundation assets and 27% of the community foundation assets were invested in alternative investments.[8] These statistics suggest that an "average-sized" endowment may be invested in a significant number of alternative investments.

The most popular vehicle of choice for structuring these investments is the limited partnership (LP) in which the exempt investors are limited partners who bear no liability but for their investment and have no decision-making authority over the assets acquired by the partnership. Another similar investment vehicle, although not as commonly used, is the limited liability company (LLC) in which the exempt investor is a non-managing member of the partnership. Similar to the role of LP, the non-managing member makes no decisions regarding the operations of this investment. Additionally, there are new investment models being introduced each year. For example, many large exempt investors are currently structuring "fund of one," which generally result in better fee structures and offer investors more tailored investment guidelines to fit the investors' risk profile. This "fund of one" is typically organized with the exempt investor as the sole limited partner in the fund, resulting in a high percentage of ownership (90% or more) but no more control over the partnership's activities than the investor would have in an investment partnership in which the investor has a very small percentage of ownership.

In accordance with the Internal Revenue Code (IRC), the partners are responsible for the resulting tax liability rather than the partnership. The partnership provides a Schedule K-1[9] each year to its partners and members, taxable and exempt investors alike, that allocates each investor's share of partnership income to be reported on their income tax returns. Exempt investors report their allocated unrelated business taxable income (UBTI) on the Form 990-T.[10] Exempt investors not subject to the passive loss limitations rules under Section 469 (typically organizations not formed as trusts such as pension plans, employee benefit trusts and certain charitable foundations) may

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[6] 2017 NACUBO, Commonfund Study of Endowments which includes 809 private and public colleges and universities associated with the National Association of Colleges and University Business Officers (NACUBO).

[7] 2017 study above, 52% of the participants invested their assets in alternative investments.

[8] 2018 Council on Foundations, Commonfund Study of Investment of Endowments for Private and Community Foundations.

[9] Schedule K-1 (form 1065), Partner's Share of Income, Deductions, Credits, etc.

[10] Form 990-T, Business Income Tax Return for Exempt Organizations.

use losses from these partnerships to offset gains from any and all other UBTI activities without restriction.

Exempt organizations that are limited partners or non-managing members in investment partnerships rely heavily on the general partner to report their tax information appropriately since they have no control over or access to the activities that generated the income. Exempt investors are particularly concerned since UBTI is a subset of partnership income, meaning not all income reported on the Schedule K-1 is subject to tax. In accordance with IRC section 6031(d), the general partner, as representative of the partnership, is obligated to include such information as is "…necessary to enable each exempt partner to compute its distributive share of partnership income or loss from such trade or business in accordance with IRC section 512(a)(1)." However, this reporting varies and, in virtually all cases, does not include any explanation or provide any authority to support its determination of UBTI. The exempt investor is challenged to manage this potential disparity or 'gap,' oftentimes entering into side letters with the general partners to ensure accuracy and establishing regular communications to verify this information.

The Notice provides that an exempt partner in a partnership that has multiple activities, whether through direct investment or as a partner in other partnerships, may be engaged in multiple unrelated trades or businesses because, as a flow-through entity, the activities of the partnership are attributed directly to the partner. Since many of these LPs or LLCs invest in other partnerships or "fund of funds," the additional burden imposed on the general partner or managing member to report the separate activities may be overwhelming and, in fact, may be extremely difficult to comply with. This is particularly true if the initial LP or LLC does not have control or significant influence over the downstream investments. Accordingly, the IRS proposed to ease this administrative burden in an effort to manage this 'gap.'

The Notice provides the *Interim* rule that allows the exempt investor to treat qualifying partnership interests (QPI) as one trade or business rather than as multiple businesses. Further, this rule allows the exempt investor to offset losses from one partnership with gains from another when the investor meets either the *de minimis* test or *control* test. The de minimis test is met if an exempt investor owns no more than 2% of the profits interests and no more than 2% of the capital interests in a partnership. The control test is met if an exempt investor owns no more than 20% of the capital interest and does not have control or influence over the partnership. The intent is to treat partnerships as a single trade or business when the exempt investors have no control or significant influence over an LP or LLC. It should be noted that both tests require combining the ownership interests of disqualified persons, supporting organizations and controlled entities to determine whether the ownership thresholds are met.

The *Interim* rule does not comport with the way exempt investors manage investable assets. Although in some states, limited partners and non-managing members may be able to vote on basic issues such as removing a general partner or managing member for matters of conflict of interests, etc., in virtually all cases, they have no right to direct, manage, supervise or engage in activities conducted by the partnerships and the lower-tier partnerships in which these partnerships invest. True to the nature of passive investments, the exempt investor's decision-making as a limited partner is curtailed to the threshold question of whether to invest in the initial partnership for the sole purpose of earning funds to support its mission. Further, exempt investors manage these investments as a single activity, typically in a central office to maximize investment income,

growth and returns. These investments serve the same narrow purpose: to generate funds to allow the exempt entity to more effectively carry out its mission. As limited liability investments, they present few if any financial risks to the exempt entity beyond the fluctuation of the value of their investments in the LPs and potential UBTI. The activity is limited to selecting investments at a high level (i.e., the partnership itself and not the underlying investments that could generate UBTI), making the requisite contributions to the partnerships and accounting for them accordingly. This is especially appropriate for a pension plan, employee benefit trust, or an endowment in which investing is a significant activity of the organization. Accordingly, an exempt investor that is a limited partner or non-managing member regardless of its percentage of ownership generally does not exercise any control over the various activities entered into or conducted by these partnerships.

We recommend that exempt investors be allowed to treat all partnership investments made as part of a diversified portfolio of investments in which the exempt investor is invested as a limited partner or non-managing member as a single activity, regardless of the investor's percentage of ownership. This approach would result in exempt investors aggregating all UBTI from partnerships. This aggregation would also significantly reduce the IRS's burden of examination in connection with auditing an exempt investor with numerous investment assets in a diversified investment portfolio. Such treatment is consistent with Section 513(c) which does not expressly include investments activities when defining a "trade or business" as an activity "carried on for the production of income from the sale of goods or the performance of services." It also furthers the intent of the Treasury Department and IRS as stated in the Section 5.02 of this Notice, to treat certain investment activities as one trade or business for purposes of Section 512(a)(6).

If the Service were to reject our recommended approach, there are some specific concerns we have related to the approach contained in the Notice:

The *Interim* Rule:

- While the *Interim* rule outlined in Section 6 of the Notice is a starting point to assist exempt investors in aggregating certain QPI into one trade or business activity, we request that the Service modify the rule, primarily to ease the burden of determining which partnership interests would qualify. We believe the *de minimis* and *control* tests are too limiting and would impose a significant burden on both the exempt investor as well as the IRS.

  We recommend the rules for determining a QPI should be aligned with other provisions in the IRC, regulations or tax form filing instructions. For instance, the *Interim* rule outlined in the Notice appears to reflect IRC section 4943, regarding the excess business holding rules applicable to private foundations and certain supporting organizations. However, there are enough differences between these two rules to confuse not only tax preparers, but the organizational employees and volunteers pulling together the information for the Form 990-T. Providing rules that use the same terminology but which are applied differently would make it more likely the rules will not be complied with correctly. Therefore, we recommend the rules be written in a manner that is easy to implement and/or aligned with other IRC sections.

  Many exempt investors invest in numerous entities classified as partnerships for tax reporting purposes. Determining the common ownership information from all the related

parties, including disqualified persons, is onerous. Many affected public charities have large boards with over one hundred members. It would be unreasonable to verify the ownership percentages for every partnership holding that generates unrelated business taxable income by the exempt investor. The exempt investor often cannot ask the partnership for a list of investors along with their ownership percentages due to confidentiality agreements. Therefore, the exempt investors would need to ascertain that information by asking their related parties. Many exempt investors with large boards would find this task extremely burdensome if not impossible. Our recommendation to treat all investment partnerships as one activity would eliminate having to combine the 'disqualified persons' ownership interests and would avoid, invasive conversations with officers, directors, trustees, and, possibly, donors. Where hundreds of investments are involved, such communications would create tremendous administrative burden that would almost certainly never produce a truly accurate result.

If our recommended approach is not adopted, we suggest including a reasonable efforts standard similar to the one included in Form 990, Part VI line 2, Part VII, and Schedule L instructions, which provide that an organization can satisfy certain reporting requirements by making a reasonable effort to obtain information from third parties. This may entail distributing an annual survey to the disqualified persons to determine if they hold an interest in these partnerships.

- The *de minimis* test for determining a qualifying partnership interest should be simplified and not require the exempt investor to combine its ownership with related interests. Even the overly prohibitive provisions of IRC section 4943 allow a private foundation to disregard the holdings of disqualified persons and commonly controlled private foundations if the ownership in the investment is 2% or less. Similarly, IRC section 951 provides US shareholders must own 10% or more of a foreign corporation to begin the analysis of whether there is a controlled foreign corporation. A less than 10% ownership interest is therefore deemed *de minimis*. If an exempt investor owns a limited interest in a partnership investment it would be more reasonable for related interests not to be taken into account for purposes of the *de minimis* test. It also would be more reasonable to increase the ownership percentage from 2% to 10%.

- The *control* test for determining a qualifying partnership interest also involves an unreasonably low threshold of influence or control and does not seem to be reflective of the current state of passive investment structuring. It is not reasonable to have the ownership threshold limited to 20%, especially when it includes combined related interests. If an exempt investor is a limited partner, then by definition it does not have control or influence over the investment partnership. This is true even in the case of a 'fund of one' in which the investor is the only LP and owns more than 90% of the partnership interests. Investors, including exempt investors, have invested via these structures to reduce fees and improve investment performance to support their missions, not for the purpose of controlling the investments held by the partnership. As such, there are a couple of options that provide a better measure of control: (1) if an exempt investor is acting as the general partner or is not paying fees to a professional money manager to act as a fiduciary in selecting investments for the partnership, or (2) the standards applicable under FASB Accounting Standards Codification 810 addressing the presumption of control (e.g., the

exempt investor would have a substantive ability to dissolve the partnership or otherwise remove the general partner without cause, substantive participation rights in making important financial and operating decision-making processes for the partnership, and the ability to influence the general partner and overall management of the partnership). If the foregoing recommendations are not acceptable to the IRS it would be more reasonable to raise the threshold to greater than 50% ownership to align with what is considered control for purposes of IRC section 512(b)(13) and the reporting requirements for Schedule R of Form 990.

Transition Rule:

- Additionally, the Notice puts forth the *Transition* rule, which allows an exempt organization to treat any partnership interest acquired prior to August 21, 2018 that fails to meet the *Interim* rule as a single trade or business without regard to any underlying activities carried on by the partnership. This rule provides relief for some partnership investments that meet neither the de minimis test nor control test. As a point of distinction, *the Transition* rule does not allow the exempt investor to aggregate UBTI from any other partnerships, even those that qualify under the *Transition rule*.

  Under the Notice, the relief provided under the *Transition* rule will not apply to investments entered into after August 21, 2018. In the case of partnership interests that are acquired after August 21, 2018 for which an exempt investor cannot meet the *Interim* rule, exempt investors would need to report each activity within the investment partnership as a separate activity if the *Interim* rule and *Transition* rule are finalized without any further modifications.

  A significant reporting and administrative burden will exist if exempt organizations are required to separately track each activity within an investment partnership as a separate activity. For the foregoing reasons, the *Transition* rule should apply to all partnership interests whether or not acquired before a particular date.

As much as the *Interim* and *Transition* rules attempt to reduce the administrative burden and help to manage the gap in reporting UBTI, they still would result in significant administrative burden for exempt investors and for the IRS, both in terms of reporting and auditing, if finalized. For instance, the *Interim* rule does not include those investments in which exempt investors hold ownership interests greater than 21%, even though as an LP the exempt investor has no control over the partnership. Also, the relief provided by the Notice should more clearly address those exempt investors whose ownership interests may increase or decrease in an unforeseeable manner and due to factors entirely outside of exempt investors' control, such as the termination or reduction of other partners' interests, an increase or decrease in the total partnership interests issued, or as capital calls are met (or are failed to be met) by all partners in the partnership, or simply due to the timing of an investment (e.g., an exempt investor may be the initial investor in a fund and others enter in subsequent closings). Clarifying language should be added to the *Transition* rule to expressly provide that these or other changes in ownership percentages do not prevent the partner from continuing to treat its entire partnership interest as comprising a single trade or business for purposes of Section 512(a)(6). The Notice does not address these changes in investment ownership interests at all. Will exempt investors be able to be treat such investments

as a single trade or business under the *Interim* rule if their interests in an investment partnership grow or decline? Will their interests qualify under the *Transition* rule if they are required by the partnership to make subsequent contributions or ownership percentages otherwise change? And what would happen to the net operating losses generated under one rule set if and when the investment moves to another rule set? For the foregoing reasons, once an exempt investor has a partnership interest that qualifies under the *Transition* rule or an "investment activities" partnership interest that qualifies under the *Interim* rule, it should not matter whether the percentage of ownership fluctuates over time.

Both the *Interim* and *Transition* rules would result in certain limited partners with no control or significant influence over certain partnerships being subject to this new layer of reporting, which may frustrate and possibly hinder their management of these reported tax liabilities. Moreover, the burden of these rules may restrict marketability to the point that the general partners of certain partnerships may refuse to allow exempt investors to participate as limited partners in investment opportunities. Other general partners may charge excessive fees to account, track, monitor and report information from various investments, which taxable investors may not be willing to share. All of the foregoing would result in less capital being available to the markets to grow businesses and the economy. Those results clearly cannot be what was intended by Congress in enacting Section 512(a)(6).

Treatment of S Corporations:

The Notice does not provide guidance for reporting UBTI received from investments in S corporations. The statutory language of IRC section 512(e) favors treatment of income received by an exempt investor from an S corporation as income received from one trade or business. IRC section 512(e)(1)(A) provides that if an applicable exempt organization holds stock in an S corporation, such interest shall be treated as an interest in an unrelated trade or business. The statutory language denotes that an exempt investor only holds an investment in one trade or business, despite the different sources of income the exempt organization earns from an S corporation investment.

Section 4 of the Notice provides that significant burden may be imposed on exempt investors if they are required to separately track income, that is not income from a partnership, but is "…included in UBTI under IRC sections 512(b)(4), (13), and (17)." Section 5 of the Notice raises similar concerns relating to reporting unrelated business income from partnership investments. Exempt investors must report all income derived from an S corporation investment as UBTI, no matter the source. A significant reporting and administrative burden would exist if exempt organizations were required to separately track and categorize different S corporation investments or different sources of income received from an S corporation investment.

Thus, we recommend allowing exempt investors to aggregate unrelated business income produced from S corporation investments together with unrelated business income produced from partnership investments. Since both types of investments are pass through investments and generate a Schedule K-1, such a rule would simplify UBTI calculation and reporting. This principle has been previously recognized as both the prior Forms 990-T and draft 2018 Form 990-T allow exempt organizations to report income and losses from partnerships and S corporations on one line together. If this recommendation is not adopted, we suggest that unless an exempt investor

holds a controlling interest in an S corporation of more than 50%, the exempt investor should be allowed to aggregate multiple interests in S corporations together with partnership investments as a single trade or business.

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We hope that these comments are helpful to you as you provide further guidance on these important issues. Thank you for your consideration.

Exhibit 2

Key Investment Concepts

Background

Exempt organizations typically invest to generate funding to further their exempt missions using a type of funding that is more reliable and predictable than gifts, grants, and donations. As the community has grown, these investments have come to significantly impact the economy. For instance, colleges and universities invested more than $630 billion in assets in fiscal year ended June 30, 2019.[11] Traditionally, over half of these investments are made in alternative investments, defined as nonconventional investments that include private equity, hedge funds, managed futures, real estate, commodities and derivative contracts. Likewise, the Council on Foundations recently surveyed 230 private foundations and community foundations and found that they invested a significant portion of their assets, $89.3 billion, in alternative investments.[12]

One type of alternative investment consists of a "fund of funds" (FOF), often referred to as multi-manager investment, which is an investment strategy that holds a portfolio of other investment funds rather than investing directly in stocks, bonds or other securities. These FOFs may be managed by an investment company, or, by managers of external funds. Despite certain differences, they share a primary advantage which is they keep the costs low and they provide diversification.

More recently a popular vehicle is the "fund of one" in which the investor, oftentimes an exempt organization, is the sole investor. The organization investor is the only limited partner, while the investment manager, who makes all of the investment decisions, is the general partner. This vehicle offers the investor the opportunity to access investments they may not otherwise be able to access, negotiate better fee structures and provides more customized diversity. Further, they offer niche strategies that allow access to the premier private equity and venture capital funds not otherwise available and serve as a feeder fund for private placement opportunities. But the sole investor typically does not control the fund of one.

In accordance with IRC Section 512(c), the partners, including flow-through LLCs, are responsible for reporting any unrelated business income and the resulting tax liability rather than the partnership. The partnership annually provides a Schedule K-1 to each limited partner and non-managing member, taxable and exempt organization investor alike, that allocates the partner's share of taxable income which the investor needs to report on their appropriate income tax returns.[13] Exempt organization investors report their allocated UBTI on the Form 990-T. Prior to the enactment of IRC Section 512(a)(6), these entities (other than those subject to the

[11] 2019 NACUBO-TIAA Study of Endowments® (NTSE) fiscal year (July 1, 2018 – June 30, 2019). National Association of Colleges and University Business Officers (NACUBO) and Teachers Insurance and Annuity Association (TIAA). https://www.nacubo.org/Press-Releases/2020/US-Educational-Endowments-Report-5-3-Percent-Average-Return-in-FY19.

[12] 2018 Council on Foundations–Commonfund Study of Investment of Endowments for Private and Community Foundations (CCSF).

[13] Schedule K-1 (form 1065), Partner's Share of Income, Deductions, Credits, etc.

passive loss limitation rules under Section 469) used losses from these partnerships to offset gains from any and all other UBTI activities without restriction.

The world of alternative investments is quite complex and provides a wide variety of investment vehicles to meet the needs of investors. We endeavor here to help explain some concepts that will be relevant to our comments and recommendations:

1. **Diversification and investment policy statement.**

Exempt organizations and employee plans seek to diversify their investment portfolios through the application of an investment policy statement. This statement guides the investment professionals with respect to the overall diversification plan taking into account risk tolerance, cash flow needs, and any special considerations of what types of investments are not permitted for the investor (e.g. due to level of risk, liquidity, perception). Investment policy statements typically identify the allocation of investments between fixed income, equity, commodities and a few other types of investments. Within each category there is normally a further allocation. In fixed income this allocation might be between treasuries, municipal bonds, corporate bonds, and within each domestic and global, varying durations, and varying risks as well as varying industries. Within equities, this allocation might be between small, mid or large capitalization, growth vs value, domestic vs international, developed vs emerging markets, public vs private etc.

The more sophisticated and larger the investor, the more sophisticated the investment policy statement. Even investments such as timber, oil & gas, shipping, leasing etc. are all part of a diversified portfolio of investments, as opposed to a desire by the exempt organization to engage in a trade or business.

2. **Cost considerations.**

The more money an exempt organization has to invest, the more complex the potential investment needs to be to achieve the desired diversification in a cost-effective manner. Some types of desirable investments are simply not available to the average individual investor but may be packaged together for the larger investors—such as private equity, hedge funds, and bond ladders—that can reduce the volatility of the overall investment portfolio. Most exempt organizations cannot have a full team of investment professionals that invest in such a diversified and large-scale manner. Instead they may have a more limited group of investment professionals on staff, or rely on an external investment committee, that finds the specialized professional managers whose job it is to keep on top of their specific market segments and have a full complement of staff that can research various investment options within their assigned market segment. The combination of pooling funds with other investors (e.g., via private equity, hedge funds, FOF) and minimizing the need to have a large internal investment management team can provide significant cost savings over the do-it-yourself model.

3. **Tiered funds.**

Within the private equity investment space, it is very common to have multiple tiers of entities, as a result of an exempt organization investor prudently diversifying its portfolio through consultation with an investment manager. Such a multi-tiered structure provides a vehicle for co-

investors to finance a particular investment. As a result, the investment fund into which the exempt organization directly invests may invest in another entity (such as a co-investment or aggregation vehicle below the fund) that in turn invests in another entity that could have third party debt, and then that entity might hold the interest in the entity which has the operating business. By the time you reach this bottom entity several levels down, the exempt organization will almost certainly indirectly own two percent (2%) or less of the actual "business activity."

a. Master-feeder structure. In a master feeder structure, investors invest through a top-tier entity (called a feeder entity) and then that entity invests into another entity (called the master fund). Using a structure such as this allows the investment fund to group its investors in a logical manner for ease of administration, and is common in the industry.

   Example. The complex nature of tiered partnership structures in which many exempt organizations invest creates a complexity and voluminous amount of underlying information. Generally, fund managers have little or no control over the reporting done by underlying managers of downstream investments. There is no guarantee that underlying managers will provide timely, complete, or accurate information that would enable the fund manager (or the organization) to separately classify and report the unrelated trade/business information.

   We have included the following example of a common investment structure. The fund manager invests at the "External Investment" level. These investments vary in strategy, and seldom if ever are done at the control or direction of the exempt organization. These external investments themselves could also be a part of a larger partnership structure in which neither the exempt organization nor the fund manager would have any insight into or ability to gain such insight. This lack of control and transparency would adversely impact the fund manager's ability to obtain the relevant information on specific unrelated trades/businesses from which UBTI is derived.

At the "Investment Holdings Entity" level, the fund manager, on behalf of the exempt organization, compiles other outside investments that are not a part of the fund manager's normal investment portfolio. These investments are comprised of a variety of strategies, industries, and activities, and each could be a part of a large tiered partnership structure. The Holding Funds, Strategy Funds and Other Investors are almost always limited partners, while the Fund Manager is the general partner.

b. <u>Investment funds with only one limited partner</u>. For large exempt organizations with significant investment portfolios that help fund their exempt purpose, it is not unusual to see such organizations invest in funds of one. In this case, the organization typically owns more than 20% of the entity but does not exercise control. Such investments serve the same purpose, and are made in the same manner, as an exempt organization's other investments. The goal is still to make an investment and to have someone else (the investment manager) make the investment decisions for the funds invested. While it is true in this situation that

the exempt organization typically has the right to "fire" the investment manager, that is no different than the right of an investor in a publicly traded mutual fund who can "fire" the manager by withdrawing its funds. In the mutual fund arena, having the right to withdraw funds isn't viewed as controlling that mutual fund and having the right to withdraw from a limited partnership (either directly or by replacing the manager – which is the same thing as withdrawing the funds and starting over with another manager) should not be viewed any differently.

4. Investment team separate from the operating team in organizations.

The people who are responsible for ensuring that investments are made pursuant to the organization's investment policy statement are normally different than the individuals who are engaged in the operating of the organization's business. The investment personnel or external investment committee seek to minimize risk and control, while the operations personnel typically seek greater control over a joint venture. The personnel that structure operating joint ventures are typically not individuals with an investment background, but are instead operational personnel who are seeking to enhance the organization's business operations. As noted above, having influence or control poses other potential liabilities and risks to an exempt organization that the organization seeks to avoid when investing.

5. Challenges for the investment fund industry to provide needed information.

In the investment world, multi-tier funds are common. The ability to get the information needed from lower tier funds has been a challenge prior to the Section 512(a)(6) UBTI calculation rules. In part, this is because a lower tier fund (in a fund of fund situation, for example) may not know who owns upper tier funds and there is always an effort by funds to not incur unnecessary costs. The investment world is highly competitive, and the ability to keep costs down and distribute Schedule K-1s early are factors considered by potential investors). See Exhibit 1 (prior TEGE Council comments on Notice 2018-67, dated January 2019) regarding the insufficient information reporting historically for exempt organization partners/ shareholders, as well as Exhibit 3 providing three sample Schedule K-1s demonstrating how information on UBTI from investments is currently reported inconsistently and incompletely by partnerships.

Exempt organization investors often do not receive adequate information from the Schedule K-1 to determine depletion, UBTI for Section 514(c)(9) qualified organizations, excess business interest, charitable contributions that may be buried in Schedule K-1, code 20V, and information needed for state UBTI reporting purposes, and need to follow up with the partnerships to obtain this information. As shown in the above tiered structure example, there can be hundreds of individual investments in a given investment portfolio.

Section 6031(d) requires partnerships to provide "such information as is necessary to enable each partner to compute its distributive share of partnership income or loss" from UBTI.[14] Although

[14] 6031(d), Separate statement of items of unrelated business taxable income, reads: "In the case of any partnership regularly carrying on a trade or business (within the meaning of section 512(c)(1)), the information required under

the investment firms generally comply with this provision, the information often varies among investment firms and, in virtually all cases, does not include any explanation or provide any authority to support the partnerships' UBTI determinations, often resulting in regular follow-up communications with these firms and, at times, preparation of side letters to verify this information. Congress has made no modification to Section 6031(d) to require partnerships to report to exempt organization investors their percentage ownership interests in downstream investments, or the portion of annual UBTI attributable to different trades or businesses or NAICS categories thereof. Thus, if the proposed regulations are finalized as proposed, general partners, fund managers, and investment firms would be faced with substantial new reporting and K-1 footnote requirements without knowing which of their direct or indirect exempt organization investors really need the information, and at what level of detail. The potential variations on the types of information that could be needed under the currently proposed regulations (especially if the Transition rule were no longer to apply), is almost unlimited.

Requiring partnerships to provide NAICS codes for trades or businesses would require significant expansion of the services provided by the tax return preparers for funds that invest in tiered funds with UBTI sources, thus increasing the costs that the exempt organizations would pay, directly or indirectly, for tax compliance services.

In addition, the look through of an upper-tier fund into the direct holdings of a second-tier fund would be burdensome on funds that make numerous investments. For instance, if adopted as proposed, the regulations would require the partnership to provide its partners with a list of all of its investments and the exempt organization investor's ownership percentages in all of them, as averaged for the holding period during the year. This would be extremely burdensome to the investment fund industry as well as to exempt organizations. Further, each upper tier partnership would also have to provide its tax-exempt partners with the income and losses flowing through from each of the underlying partnerships that generate UBTI. This could be extremely burdensome to the investment funds, and could cause some investment managers to limit investments by exempt organizations, thereby adversely impacting the ability of large exempt organizations to invest efficiently.

Exhibit 3(A) includes an exempt organization that has less than 2% capital and profits interest in the partnership with an ending capital balance of $16.6M. The Schedule shows ordinary business loss of ($3,449) on line 1, interest income of $19,635 on line 5, ordinary dividends of $10 on line 6a and long-term capital gains of $2,651,419 on line 9a. Although this entity has an ordinary business loss on line 1, the general partner makes no mention as to whether this activity generates UBTI.

Exhibit 3(B) includes an exempt organization that has less than 5% capital and profits interest in the partnership with an ending capital balance of $24M. The Schedule shows ordinary business loss of ($88,432) on line 1, interest income of $120,778 on line 5, ordinary dividends of

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subsection (b) to be furnished to its partners shall include such information as is necessary to enable each partner to compute its distributive share of partnership income or loss from such trade or business in accordance with section 512(a)(1), but without regard to the modifications described in paragraphs (8) through (15) of section 512(b)."

$661,758 on line 6a, long-term capital gains of $132,650 on line 9a and other portfolio income of $36,870 on line 11A. Line 20, letter V shows UBTI loss of ($83,818) without any mention of how it is computed or which streams of revenue generated UBTI.

Exhibit 3(C) includes an exempt organization that has less than 20% capital and profits interest in the partnership with an ending capital balance of $21.6M. The Schedule shows ordinary business loss of ($4,497) on line 1, interest income of $1,461,720 on line 5, short-term capital loss of ($79,404) on line 8, long-term capital loss of ($2,503,501) on line 9a and other portfolio income of $31,777 on line 11A. Line 20, letter V shows UBTI loss of ($6,127). Similar to Schedule K-1 in Exhibit 3(B), it makes no mention of how it is computed or which streams of revenue generated UBTI.

Exhibit 3(D) includes an exempt organization that has more than 20% capital interest in the partnership with an ending capital balance of $7.2M. The Schedule shows ordinary business loss of ($357,591) on line 1, interest income of $4 and line 20, letter V shows UBTI loss of ($307,561). Similar to Scheduled K-1 in Exhibit 3(B) and (C), it makes no mention of how it is computed or which streams of revenue generated UBTI.

In each of these scenarios, regardless of the significant amount of capital contributed, anywhere from $7 million to $24 million and the percentage of ownership anywhere from below 2% to greater than 20%, the exempt organization must follow up with the general partner to determine the tax consequences of its investments. Questions include whether some or all of the ordinary business on line 1 is related or unrelated to the entity's exempt mission and whether some or all of the short-term capital loss is included in the UBTI calculation to ensure that it is not offset against ordinary income, if any, and whether UBTI derived from debt financed properties, if any, is computed appropriately.

The additional burden placed on general partners, including downstream general partners, to provide two-digit codes only increases these challenges in reporting this information accurately and completely. General partners must ensure that the Schedule K-1 specifically delineates UBTI derived from operations in contrast to UBTI derived from debt leveraged properties since the former may be reported using the two-digit codes and the latter will be reported as QPI. Further, general partners may use different two-digit codes for the same business or type of investment, resulting in the exempt investor reporting UBTI inconsistently. General partners in downstream investments may conduct one business and, thus, are not required to provide any codes yet each downstream investment conducts a different business, resulting in the exempt investor reporting one separate business from this investment when, in fact, it invested in multiple businesses with various two-digit codes. Clearly, exempt investors may not receive the appropriate information and, even when reliable, the General partners will charge them exorbitant fees to provide it.

6. Administrative burden of exempt organizations that own alternative investments

Although smaller tax-exempt organizations often "block" UBTI by investing through a corporate blocker, the vast majority of larger investors invest through partnerships, as they are far more tax-efficient. For larger exempt organization investors, typically 20% to 40% of their Schedule K-1s report unrelated business income. Having to classify an organization's partnerships

between QPIs and non-QPIs and make appropriate elections as to NAICS code classification would be very time consuming for many exempt organization investors that receive hundreds, if not thousands, of Schedule K-1s from investment partnerships.

As explained in greater detail below, organizations are already required to segment, for financial reporting purposes, their partnerships into operating partnerships vs non-operating investments. Requiring yet another segmentation of investments would add to the burden of exempt organizations, with little impact on tax compliance and tenuous nexus to the purpose of the UBTI rules or 512(a)(6).

In the Preamble to the Proposed Regulations, the IRS and Treasury expressed concern about recognizing as partnership investments all partnerships in which the exempt organization is a non-managing member, due to a perceived view of differing state laws for determining non-managing member equivalent interests. However, relying on accounting standards for distinguishing partnership investments from operating partnerships, as explained below, would eliminate this concern, and would be much easier than determining partnership interests based on ownership percentages and control of multi-tiered partnerships.

Exempt organizations already face the challenge of timely obtaining the UBTI information they need from partnerships in which they invest, often requiring significant follow-up to obtain that information to make timely UBTI payments. In some cases, they do not receive Schedule K-1s by their Form 990 and 990-T filing deadlines. See Exhibit 1 for prior comments in this regard.

Corporate tax-exempt investors and tax-exempt investors organized as trusts, while both having the burden of obtaining accurate and timely information from the fund, also have different filing requirements to consider.

Tax-exempt trusts, in addition to Section 512(a)(6), are subject to the limitations imposed by Sections 55, 163(j), 465, and 469 and may be required to calculate a deduction under Section 199A as well. This leads to numerous reiterations to arrive at the final UBTI amount to be reported on Form 990-T. Currently there is no commercial software we are aware of that will perform these calculations correctly and in the proper order. When combined with the information gathering issues described above, it is a very onerous and administratively burdensome task for tax-exempt trusts to accurately compute UBTI.

Corporate tax-exempt investors are subject to the same limitations as those imposed on tax exempt trusts, with the exception of Sections 55 (for taxable years beginning after 12/31/17) and 469, and are not allowed a deduction under Section 199A. Corporations are also subject to Sections 59A and 951A to the extent that any passthrough UBTI is considered Subpart F income, which adds another layer of complexity to the UBTI calculation. The administrative burden of attempting to obtain accurate and timely information from funds regarding taxpayer-level deductions, such as those for depletion expense and charitable contributions, apply to both tax-exempt trusts and corporations.

7. Ownership percentage determination challenges

Partnerships often seek investors over a period of time – which can be up to 18 to 24 months. Depending on when an investor enters the partnership, its initial ownership percentage could be significantly higher than the percentage it will ultimately own. For example, assume exempt organization investors 1 and 2 are the first investors in a partnership, with the intent of acquiring 2% of the total amount available for subscription, and have submitted their contributions to the partnership on 12/30. Assume a 12/31 partnership year end. Assume the rest of the subscriptions are fulfilled over the next 18 months. In year one, these two exempt organization investors might each own 50% of the partnership, but then after 18 months own only 2% each.

On the other hand, an exempt organization might have an ownership interest in a fund that increases significantly due to no action on its part. For example, another investor may withdraw from the partnership, causing the percentage owned by the remaining investors to increase, even if the value of their interests have not changed.

If an increase in ownership occurs simply because of what other partners do, then the exempt organization may not know that its investment failed to meet the test for a QPI until receiving its Schedule K-1, possibly months after year-end, causing potentially unexpected increases in tax liability.

Exhibit 3

651119

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

2019

For calendar year 2019, or tax year beginning 2019 ending

Partner's Share of Income, Deductions, Credits, etc.

▶ See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number

B Partnership's name, address, city, state, and ZIP code

C IRS Center where partnership filed return ▶ ELECTRONIC FILING

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See inst.)

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.

G ☐ General partner or LLC member-manager ☒ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:

TIN Name

I1 What type of entity is this partner? EXEMPT ORGANIZATION

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	1.498801 %	1.498801 %
Loss	1.498801 %	1.498801 %
Capital	1.308828 %	1.272461 %

Check if decrease is due to sale or exchange of partnership interest . . ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse . .	$	$
Qualified nonrecourse financing . . .	$	$
Recourse . . .	$	$

☐ Check this box if Item K includes liability amounts from lower tier partnerships.

L Partner's Capital Account Analysis

Beginning capital account . . .	$ 18,243,238
Capital contributed during the year . .	$
Current year net income (loss) . . .	$ 2,319,265
Other increase (decrease) (attach explanation)	$ -980,592
Withdrawals & distributions . . .	$ (2,944,554)
Ending capital account	$ 16,637,357

M Did the partner contribute property with a built-in gain or loss?

☐ Yes ☒ No If "Yes," attach statement. See instructions.

N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)

Beginning . . . . . $

Ending . . . . . $

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss) -3,449	15	Credits
2	Net rental real estate income (loss)		
3	Other net rental income (loss)	16	Foreign transactions
		A	OTHER
4a	Guaranteed payments for services	B	2,701,064
4b	Guaranteed payments for capital	C	2,681,419
4c	Total guaranteed payments	F	2,880
5	Interest income 19,635	M	8,612
6a	Ordinary dividends 10		
6b	Qualified dividends		
6c	Dividend equivalents	17	Alternative minimum tax (AMT) items
7	Royalties		
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss) 2,681,419	18	Tax-exempt income and nondeductible expenses
9b	Collectibles (28%) gain (loss)		
9c	Unrecaptured section 1250 gain		
10	Net section 1231 gain (loss)	19	Distributions
11	Other income (loss)	A	2,641,131
		C	303,423
		20	Other information
12	Section 179 deduction	A	19,645
13	Other deductions		
W	388,282	B	388,282
14	Self-employment earnings (loss)		

21 ☐ More than one activity for at-risk purposes*

22 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

This list identifies the codes used on Schedule K-1 for all partners and provides summarized reporting information for partners who file Form 1040 or 1040-SR. For detailed reporting and filing information, see the separate Partner's Instructions for Schedule K-1 and the instructions for your income tax return.

		Report on
1.	**Ordinary business income (loss).** Determine whether the income (loss) is passive or nonpassive and enter on your return as follows.	
	Passive loss	See the Partner's Instructions
	Passive income	Schedule E, line 28, column (h)
	Nonpassive loss	See the Partner's Instructions
	Nonpassive income	Schedule E, line 28, column (k)
2.	**Net rental real estate income (loss)**	See the Partner's Instructions
3.	**Other net rental income (loss)**	
	Net income	Schedule E, line 28, column (h)
	Net loss	See the Partner's Instructions
4a.	**Guaranteed payment Services**	See the Partner's Instructions
4b.	**Guaranteed payment Capital**	See the Partner's Instructions
4c.	**Guaranteed payment Total**	See the Partner's Instructions
5.	**Interest income**	Form 1040 or 1040-SR, line 2b
6a.	**Ordinary dividends**	Form 1040 or 1040-SR, line 3b
6b.	**Qualified dividends**	Form 1040 or 1040-SR, line 3a
6c.	**Dividend equivalents**	See the Partner's Instructions
7.	**Royalties**	Schedule E, line 4
8.	**Net short-term capital gain (loss)**	Schedule D, line 5
9a.	**Net long-term capital gain (loss)**	Schedule D, line 12
9b.	**Collectibles (28%) gain (loss)**	28% Rate Gain Worksheet, line 4 (Schedule D instructions)
9c.	**Unrecaptured section 1250 gain**	See the Partner's Instructions
10.	**Net section 1231 gain (loss)**	See the Partner's Instructions
11.	**Other income (loss)**	
	Code	
	A Other portfolio income (loss)	See the Partner's Instructions
	B Involuntary conversions	See the Partner's Instructions
	C Sec. 1256 contracts & straddles	Form 6781, line 1
	D Mining exploration costs recapture	See Pub. 535
	E Cancellation of debt	See the Partner's Instructions
	F Section 743(b) positive adjustments	
	G Section 965(a) inclusion	
	H Income under subpart F (other than inclusions under sections 951A and 965)	
	I Other income (loss)	
12.	**Section 179 deduction**	See the Partner's Instructions
13.	**Other deductions**	
	A Cash contributions (60%)	See the Partner's Instructions
	B Cash contributions (30%)	
	C Noncash contributions (50%)	
	D Noncash contributions (30%)	
	E Capital gain property to a 50% organization (30%)	
	F Capital gain property (20%)	
	G Contributions (100%)	
	H Investment interest expense	Form 4952, line 1
	I Deductions—royalty income	Schedule E, line 19
	J Section 59(e)(2) expenditures	See the Partner's Instructions
	K Excess business interest expense	See the Partner's Instructions
	L Deductions—portfolio (other)	Schedule A, line 16
	M Amounts paid for medical insurance	Schedule A, line 1, or Schedule 1 (Form 1040 or 1040-SR), line 16
	N Educational assistance benefits	See the Partner's Instructions
	O Dependent care benefits	Form 2441, line 12
	P Preproductive period expenses	See the Partner's Instructions
	Q Commercial revitalization deduction from rental real estate activities	See Form 8582 instructions
	R Pensions and IRAs	See the Partner's Instructions
	S Reforestation expense deduction	See the Partner's Instructions
	T through **U**	Reserved for future use
	V Section 743(b) negative adjustments	See the Partner's Instructions
	W Other deductions	
	X Section 965(c) deduction	
14.	**Self-employment earnings (loss)**	
	Note: If you have a section 179 deduction or any partner-level deductions, see the Partner's Instructions before completing Schedule SE.	
	A Net earnings (loss) from self-employment	Schedule SE, Section A or B
	B Gross farming or fishing income	See the Partner's Instructions
	C Gross non-farm income	See the Partner's Instructions
15.	**Credits**	
	A Low-income housing credit (section 42(j)(5)) from pre-2008 buildings	See the Partner's Instructions
	B Low-income housing credit (other) from pre-2008 buildings	
	C Low-income housing credit (section 42(j)(5)) from post-2007 buildings	
	D Low-income housing credit (other) from post-2007 buildings	
	E Qualified rehabilitation expenditures (rental real estate)	
	F Other rental real estate credits	
	G Other rental credits	
	H Undistributed capital gains credit	Schedule 3 (Form 1040 or 1040-SR), line 13, box a
	I Biofuel producer credit	See the Partner's Instructions
	J Work opportunity credit	See the Partner's Instructions
	K Disabled access credit	
	L Empowerment zone employment credit	
	M Credit for increasing research activities	
	N Credit for employer social security and Medicare taxes	
	O Backup withholding	
	P Other credits	
16.	**Foreign transactions**	
	A Name of country or U.S. possession	Form 1116, Part I
	B Gross income from all sources	
	C Gross income sourced at partner level	
	Foreign gross income sourced at partnership level	
	D Reserved for future use	Form 1116, Part I
	E Foreign branch category	
	F Passive category	
	G General category	
	H Other	
	Deductions allocated and apportioned at partner level	
	I Interest expense	Form 1116, Part I
	J Other	Form 1116, Part I
	Deductions allocated and apportioned at partnership level to foreign source income	
	K Reserved for future use	Form 1116, Part I
	L Foreign branch category	
	M Passive category	
	N General category	
	O Other	
	Other information	
	P Total foreign taxes paid	Form 1116, Part II
	Q Total foreign taxes accrued	Form 1116, Part II
	R Reduction in taxes available for credit	Form 1116, line 12
	S Foreign trading gross receipts	Form 8873
	T Extraterritorial income exclusion	Form 8873
	U through **V**	Reserved for future use
	W Section 965 information	See the Partner's Instructions
	X Other foreign transactions	
17.	**Alternative minimum tax (AMT) items**	
	A Post-1986 depreciation adjustment	See the Partner's Instructions and the Instructions for Form 6251
	B Adjusted gain or loss	
	C Depletion (other than oil & gas)	
	D Oil, gas, & geothermal—gross income	
	E Oil, gas, & geothermal—deductions	
	F Other AMT items	
18.	**Tax-exempt income and nondeductible expenses**	
	A Tax-exempt interest income	Form 1040 or 1040-SR, line 2a
	B Other tax-exempt income	See the Partner's Instructions
	C Nondeductible expenses	See the Partner's Instructions
19.	**Distributions**	
	A Cash and marketable securities	See the Partner's Instructions
	B Distribution subject to section 737	
	C Other property	
20.	**Other information**	
	A Investment income	Form 4952, line 4a
	B Investment expenses	Form 4952, line 5
	C Fuel tax credit information	Form 4136
	D Qualified rehabilitation expenditures (other than rental real estate)	See the Partner's Instructions
	E Basis of energy property	
	F through **G**	
	H Recapture of investment credit	See Form 4255
	I Recapture of other credits	See the Partner's Instructions
	J Look-back interest—completed long-term contracts	See Form 8697
	K Look-back interest—income forecast method	See Form 8866
	L Dispositions of property with section 179 deductions	See the Partner's Instructions
	M Recapture of section 179 deduction	
	N Interest expense for corporate partners	
	O through **Y**	
	Z Section 199A information	
	AA Section 704(c) information	
	AB Section 751 gain (loss)	
	AC Section 1(h)(5) gain (loss)	
	AD Deemed section 1250 unrecaptured gain	
	AE Excess taxable income	
	AF Excess business interest income	
	AG Gross receipts for section 59A(e)	
	AH Other information	

PARTNER'S CAPITAL ACCOUNT

THE PARTNER'S CAPITAL ACCOUNT ON ITEM L IS PRESENTED ON GAAP BASIS. THE PARTNER'S SHARE OF INCOME (LOSS) DETERMINED UNDER GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) DIFFERS FROM PARTNER'S SHARE OF TAXABLE INCOME (LOSS) DUE TO VARIOUS BOOK-TAX DIFFERENCES.

ITEM L - OTHER INCREASE/(DECREASE)	
EXCESS FMV OVER COST ON DISTRIBUTION OF STOCK	-980,592
TOTAL OTHER INCREASE/(DECREASE) PER ITEM L	**-980,592**

LINE 5 - INTEREST INCOME	
BANK INTEREST - U.S.	16,765
BANK INTEREST - FOREIGN	2,870
TOTAL INTEREST INCOME	**19,635**

LINE 6A - ORDINARY DIVIDENDS	
ORDINARY DIVIDENDS - FOREIGN	10
TOTAL ORDINARY DIVIDENDS	**10**

LINE 13W - OTHER DEDUCTIONS	
PORTFOLIO DEDUCTIONS (FORMERLY DEDUCTIBLE BY INDIVIDUALS UNDER SECTION 67 SUBJECT TO 2% AGI FLOOR)	388,282
TOTAL BOX W - OTHER DEDUCTIONS	**388,282**

REPORTABLE TRANSACTIONS

THE PARTNERSHIP HAD NO REPORTABLE TRANSACTIONS DURING THE YEAR. NO DISCLOSURES ARE REQUIRED UNDER REG. SEC. 1.6011-4 (FORM 8886).

LINE 20B - INVESTMENT EXPENSES

THE AMOUNT REPORTED ON LINE 20B INCLUDES INVESTMENT EXPENSES FROM LINES 13I, 13L, AND 13W, IF ANY, OF YOUR SCHEDULE K-1. ADDITIONAL LIMITATIONS MAY APPLY. PLEASE CONSULT YOUR TAX ADVISOR.

LINE 20Y - NET INVESTMENT INCOME

UNLESS OTHERWISE NOTED, THE DISTRIBUTIVE SHARE OF ALL ITEMS INCLUDED ON YOUR SCHEDULE K-1 ARE ALL COMPONENTS OF NET INVESTMENT INCOME AS DEFINED IN TREAS. REG. 1.1411-4 AND MAY BE SUBJECT TO THE NET INVESTMENT INCOME TAX PURSUANT TO IRC SECTION 1411. PLEASE CONSULT YOUR TAX ADVISOR.

TRANSFER OF PROPERTY TO A FOREIGN CORPORATION (FORM 926)

THE PARTNERSHIP HAD NO TRANSFERS OF PROPERTY TO A FOREIGN CORPORATION DURING THE YEAR FOR WHICH DISCLOSURES ARE REQUIRED UNDER REG. SEC. 1.6038B-1 & 1T (FORM 926).

LINE 9A - NET LONG-TERM CAPITAL GAIN (LOSS)

UNDER IRC SECTION 1061, TAXPAYERS MAY BE REQUIRED TO RECHARACTERIZE A PORTION OF NET LONG-TERM CAPITAL GAIN REPORTED ON LINE 9A AS SHORT-TERM CAPITAL GAIN IF THE GAIN WAS FROM AN APPLICABLE PARTNERSHIP INTEREST AND DID NOT MEET THE THREE-YEAR HOLDING PERIOD REQUIREMENT. THE FOLLOWING INFORMATION IS TO ASSIST WITH YOUR TAX RETURN PREPARATION. PLEASE CONSULT YOUR TAX ADVISOR.

NET LT CAPITAL GAIN/(LOSS) FROM PROPERTY HELD 3 YEARS OR LESS:	518,207
NET LT CAPITAL GAIN/(LOSS) FROM PROPERTY HELD MORE THAN 3 YEARS:	2,163,212
TOTAL NET LONG-TERM CAPITAL GAIN/(LOSS)	**2,681,419**

STOCK DISTRIBUTIONS

UNDER IRC SECTION 1061, TAXPAYERS MAY BE REQUIRED TO RECHARACTERIZE A PORTION OF NET LONG-TERM CAPITAL GAIN FROM A DISPOSITION OF STOCK AS SHORT-TERM CAPITAL GAIN IF THE STOCK WAS RECEIVED FROM AN APPLICABLE PARTNERSHIP INTEREST AND HELD 3 YEARS OR LESS. PLEASE CONSULT YOUR TAX ADVISOR REGARDING THE IMPACT OF SECTION 1061 TO YOU ON THE DISPOSAL OF THESE SHARES. CONTACT THE PARTNERSHIP TO DETERMINE IF THE SHARES ARE CONSIDERED TO BE FROM AN APPLICABLE PARTNERSHIP INTEREST, AS NEEDED.

- NUMBER OF SHARES	1,199
- COST BASIS OF STOCK	$5,455

- NUMBER OF SHARES	10,464
- COST BASIS OF STOCK	$61,319

- NUMBER OF SHARES	40,384
- COST BASIS OF STOCK	$236,649

651119

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1065)
Department of the Treasury
Internal Revenue Service

2019

For calendar year 2019, or tax year beginning / / 2019 ending / /

Partner's Share of Income, Deductions, Credits, etc.

▶ See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number

B Partnership's name, address, city, state, and ZIP code

C IRS Center where partnership filed return ▶ eFile

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See inst.)

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.

G ☐ General partner or LLC member-manager ☒ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN _____ Name _____

I1 What type of entity is this partner? Exempt Org.

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	3.389100 %	3.341600 %
Loss	3.389100 %	3.341600 %
Capital	3.389100 %	3.341600 %

Check if decrease is due to sale or exchange of partnership interest . . ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$ 6,852	$ 23,390
Qualified nonrecourse financing	$	$
Recourse	$	$

☒ Check this box if Item K includes liability amounts from lower tier partnerships.

L Partner's Capital Account Analysis

Beginning capital account	$ 20,166,991
Capital contributed during the year	$ 7,312,500
Current year net income (loss)	$ 843,602
Other increase (decrease) (attach explanation)	$ (3,243,173)
Withdrawals & distributions	$ (1,002,429)
Ending capital account	$ 24,077,491

M Did the partner contribute property with a built-in gain or loss?
☐ Yes ☒ No If "Yes," attach statement. See instructions.

N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)
Beginning . . . . . $
Ending . . . . . $

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	(88,432)	15	Credits	
2	Net rental real estate income (loss)				
3	Other net rental income (loss)		16	Foreign transactions	
			A		OC
4a	Guaranteed payments for services		B		952,056
4b	Guaranteed payments for capital		C		169,520
4c	Total guaranteed payments		F		662,305
5	Interest income	120,778	I		31,724
6a	Ordinary dividends	661,758	J		746,473
6b	Qualified dividends	661,758			
6c	Dividend equivalents		17	Alternative minimum tax (AMT) items	
7	Royalties				
8	Net short-term capital gain (loss)				
9a	Net long-term capital gain (loss)	132,650	18	Tax-exempt income and nondeductible expenses	
9b	Collectibles (28%) gain (loss)		C		1,179
9c	Unrecaptured section 1250 gain				
10	Net section 1231 gain (loss)				
11	Other income (loss)		19	Distributions	
A		36,870	A		1,002,429
			20	Other information	
12	Section 179 deduction		A		782,536
13	Other deductions		B		110
H		31,724			
L		110	V		(83,818)
W		746,473	*		STMT
14	Self-employment earnings (loss)				

21 ☐ More than one activity for at-risk purposes*
22 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

This list identifies the codes used on Schedule K-1 for all partners and provides summarized reporting information for partners who file Form 1040 or 1040-SR. For detailed reporting and filing information, see the separate Partner's Instructions for Schedule K-1 and the instructions for your income tax return.

		Report on
1.	**Ordinary business income (loss).** Determine whether the income (loss) is passive or nonpassive and enter on your return as follows.	
	Passive loss	See the Partner's Instructions
	Passive income	Schedule E, line 28, column (h)
	Nonpassive loss	See the Partner's Instructions
	Nonpassive income	Schedule E, line 28, column (k)
2.	**Net rental real estate income (loss)**	See the Partner's Instructions
3.	**Other net rental income (loss)**	
	Net income	Schedule E, line 28, column (h)
	Net loss	See the Partner's Instructions
4a.	**Guaranteed payment Services**	See the Partner's Instructions
4b.	**Guaranteed payment Capital**	See the Partner's Instructions
4c.	**Guaranteed payment Total**	See the Partner's Instructions
5.	**Interest income**	Form 1040 or 1040-SR, line 2b
6a.	**Ordinary dividends**	Form 1040 or 1040-SR, line 3b
6b.	**Qualified dividends**	Form 1040 or 1040-SR, line 3a
6c.	**Dividend equivalents**	See the Partner's Instructions
7.	**Royalties**	Schedule E, line 4
8.	**Net short-term capital gain (loss)**	Schedule D, line 5
9a.	**Net long-term capital gain (loss)**	Schedule D, line 12
9b.	**Collectibles (28%) gain (loss)**	28% Rate Gain Worksheet, line 4 (Schedule D instructions)
9c.	**Unrecaptured section 1250 gain**	See the Partner's Instructions
10.	**Net section 1231 gain (loss)**	See the Partner's Instructions
11.	**Other income (loss)**	
	Code	
	A Other portfolio income (loss)	See the Partner's Instructions
	B Involuntary conversions	See the Partner's Instructions
	C Sec. 1256 contracts & straddles	Form 6781, line 1
	D Mining exploration costs recapture	See Pub. 535
	E Cancellation of debt	See the Partner's Instructions
	F Section 743(b) positive adjustments	
	G Section 965(a) inclusion	
	H Income under subpart F (other than inclusions under sections 951A and 965)	
	I Other income (loss)	
12.	**Section 179 deduction**	See the Partner's Instructions
13.	**Other deductions**	
	A Cash contributions (60%)	See the Partner's Instructions
	B Cash contributions (30%)	
	C Noncash contributions (50%)	
	D Noncash contributions (30%)	
	E Capital gain property to a 50% organization (30%)	
	F Capital gain property (20%)	
	G Contributions (100%)	
	H Investment interest expense	Form 4952, line 1
	I Deductions—royalty income	Schedule E, line 19
	J Section 59(e)(2) expenditures	See the Partner's Instructions
	K Excess business interest expense	See the Partner's Instructions
	L Deductions—portfolio (other)	Schedule A, line 16
	M Amounts paid for medical insurance	Schedule A, line 1, or Schedule 1 (Form 1040 or 1040-SR), line 16
	N Educational assistance benefits	See the Partner's Instructions
	O Dependent care benefits	Form 2441, line 12
	P Preproductive period expenses	See the Partner's Instructions
	Q Commercial revitalization deduction from rental real estate activities	See Form 8582 instructions
	R Pensions and IRAs	See the Partner's Instructions
	S Reforestation expense deduction	See the Partner's Instructions
	T through **U**	Reserved for future use
	V Section 743(b) negative adjustments	See the Partner's Instructions
	W Other deductions	
	X Section 965(c) deduction	
14.	**Self-employment earnings (loss)**	

Note: If you have a section 179 deduction or any partner-level deductions, see the Partner's Instructions before completing Schedule SE.

	A Net earnings (loss) from self-employment	Schedule SE, Section A or B
	B Gross farming or fishing income	See the Partner's Instructions
	C Gross non-farm income	See the Partner's Instructions
15.	**Credits**	
	A Low-income housing credit (section 42(j)(5)) from pre-2008 buildings	See the Partner's Instructions
	B Low-income housing credit (other) from pre-2008 buildings	
	C Low-income housing credit (section 42(j)(5)) from post-2007 buildings	
	D Low-income housing credit (other) from post-2007 buildings	
	E Qualified rehabilitation expenditures (rental real estate)	
	F Other rental real estate credits	
	G Other rental credits	
	Code	*Report on*
	H Undistributed capital gains credit	Schedule 3 (Form 1040 or 1040-SR), line 13, box a
	I Biofuel producer credit	See the Partner's Instructions
	J Work opportunity credit	See the Partner's Instructions
	K Disabled access credit	
	L Empowerment zone employment credit	
	M Credit for increasing research activities	
	N Credit for employer social security and Medicare taxes	
	O Backup withholding	
	P Other credits	
16.	**Foreign transactions**	
	A Name of country or U.S. possession	Form 1116, Part I
	B Gross income from all sources	
	C Gross income sourced at partner level	
	Foreign gross income sourced at partnership level	
	D Reserved for future use	
	E Foreign branch category	Form 1116, Part I
	F Passive category	
	G General category	
	H Other	
	Deductions allocated and apportioned at partner level	
	I Interest expense	Form 1116, Part I
	J Other	Form 1116, Part I
	Deductions allocated and apportioned at partnership level to foreign source income	
	K Reserved for future use	Form 1116, Part I
	L Foreign branch category	
	M Passive category	
	N General category	
	O Other	
	Other information	
	P Total foreign taxes paid	Form 1116, Part II
	Q Total foreign taxes accrued	Form 1116, Part II
	R Reduction in taxes available for credit	Form 1116, line 12
	S Foreign trading gross receipts	Form 8873
	T Extraterritorial income exclusion	Form 8873
	U through **V**	Reserved for future use
	W Section 965 information	See the Partner's Instructions
	X Other foreign transactions	
17.	**Alternative minimum tax (AMT) items**	
	A Post-1986 depreciation adjustment	See the Partner's Instructions and the Instructions for Form 6251
	B Adjusted gain or loss	
	C Depletion (other than oil & gas)	
	D Oil, gas, & geothermal—gross income	
	E Oil, gas, & geothermal—deductions	
	F Other AMT items	
18.	**Tax-exempt income and nondeductible expenses**	
	A Tax-exempt interest income	Form 1040 or 1040-SR, line 2a
	B Other tax-exempt income	See the Partner's Instructions
	C Nondeductible expenses	See the Partner's Instructions
19.	**Distributions**	
	A Cash and marketable securities	See the Partner's Instructions
	B Distribution subject to section 737	
	C Other property	
20.	**Other information**	
	A Investment income	Form 4952, line 4a
	B Investment expenses	Form 4952, line 5
	C Fuel tax credit information	Form 4136
	D Qualified rehabilitation expenditures (other than rental real estate)	See the Partner's Instructions
	E Basis of energy property	
	F through **G**	
	H Recapture of investment credit	See Form 4255
	I Recapture of other credits	See the Partner's Instructions
	J Look-back interest—completed long-term contracts	See Form 8697
	K Look-back interest—income forecast method	See Form 8866
	L Dispositions of property with section 179 deductions	See the Partner's Instructions
	M Recapture of section 179 deduction	
	N Interest expense for corporate partners	
	O through **Y**	
	Z Section 199A information	
	AA Section 704(c) information	
	AB Section 751 gain (loss)	
	AC Section 1(h)(5) gain (loss)	
	AD Deemed section 1250 unrecaptured gain	
	AE Excess taxable income	
	AF Excess business interest income	
	AG Gross receipts for section 59A(e)	
	AH Other information	

PART II, ITEM L - CURRENT YEAR INCOME (LOSS) RECONCILIATION

NET INCOME (LOSS) FROM SCHEDULE K-1, BOXES 1-6A, 7, 8, 9A, 10, 11	863,624
DEDUCTIONS FROM SCHEDULE K-1, BOXES 12-13, 16 CODE P, 16 CODE Q	(778,307)
TOTAL TAXABLE INCOME (LOSS) PER SCHEDULE K-1	85,317
UNREALIZED APPRECIATION (DEPRECIATION) AND TIMING DIFFERENCES	758,573
OTHER TIMING DIFFERENCES	891
NONDEDUCTIBLE EXPENSES	(1,179)
TOTAL NET BOOK INCOME	843,602

PART II, ITEM L - CURRENT YEAR OTHER INCREASE (DECREASE) RECONCILIATION

TRANSFER OF INTEREST OUT	(3,243,173)
TOTAL CURRENT YEAR OTHER INCREASE (DECREASE)	(3,243,173)

ITEM L - CURRENT YEAR WITHDRAWALS & DISTRIBUTIONS RECONCILIATION

CASH WITHDRAWALS & DISTRIBUTIONS	1,002,429
TOTAL WITHDRAWALS & DISTRIBUTIONS	1,002,429

BOX 1 - ORDINARY BUSINESS INCOME (LOSS)

OTHER ORDINARY INCOME (LOSS)	(88,432)
TOTAL BOX 1	(88,432)

BOX 5 - INTEREST INCOME

U.S. SOURCED INTEREST INCOME	120,231
FOREIGN SOURCED INTEREST INCOME	547
TOTAL BOX 5	120,778

BOX 6A - ORDINARY DIVIDENDS (INCL. QUALIFIED DIVIDENDS)

FOREIGN DIVIDENDS	661,758
TOTAL BOX 6A	661,758

BOX 6B - QUALIFIED DIVIDENDS

QUALIFIED FOREIGN DIVIDENDS	661,758
TOTAL BOX 6B	661,758

BOX 11 - OTHER INCOME (LOSS)

A - OTHER PORTFOLIO INCOME (LOSS)

SECTION 988 GAIN (LOSS)	30,431
OTHER PORTFOLIO INCOME (LOSS)	6,439
TOTAL BOX 11 CODE A	36,870

BOX 13 - OTHER DEDUCTIONS

H - INVESTMENT INTEREST EXPENSE	
INVESTMENT INTEREST EXPENSE FROM INVESTING ACTIVITIES	31,724
TOTAL BOX 13 CODE H	31,724
L - DEDUCTIONS-PORTFOLIO (OTHER)	
PORTFOLIO DEDUCTIONS	110
TOTAL BOX 13 CODE L	110
W - OTHER DEDUCTIONS	
PORTFOLIO DEDUCTIONS - OTHER (FORMERLY DEDUCTIBLE UNDER SEC 67 SUBJ TO 2% FLOOR)	746,473
TOTAL BOX 13 CODE W	746,473
BOX 20 - OTHER INFORMATION	
A - INVESTMENT INCOME	782,536
B - INVESTMENT EXPENSES	110
V - UNRELATED BUSINESS TAXABLE INCOME	
UBTI - ORDINARY INCOME (EXPENSE)	(83,818)
TOTAL BOX 20 CODE V	(83,818)
Z - SECTION 199A INFORMATION	
SECTION 199A INCOME	(83,818)
SECTION 199A W-2 WAGES	135,045
SECTION 199A UNADJUSTED BASIS	2,798
TOTAL BOX 20 CODE Z	54,025
AG - GROSS RECEIPTS FOR SECTION 59A(E)	5,328

BOX 6A AND 6B - ORDINARY AND QUALIFIED DIVIDENDS

LP HAS RECEIVED FOLLOWING DIVIDEND DISTRIBUTION FROM BELOW LISTED CONTROLLED FOREIGN CORPORATION (CFCI):

YOUR PORTION OF ORDINARY FOREIGN DIVIDEND FROM LTD IS: YOUR PORTION OF	78,819
QUALIFIED FOREIGN DIVIDEND FROM LTD IS: YOUR PORTION OF ORDINARY FOREIGN	78,819
DIVIDEND FROM LTD IS:	332,252
YOUR PORTION OF QUALIFIED FOREIGN DIVIDEND FROM LTD IS:	332,252
YOUR PORTION OF ORDINARY FOREIGN DIVIDEND FROM LTD IS: YOUR PORTION OF	250,687
QUALIFIED FOREIGN DIVIDEND FROM LTD IS:	250,687

IF YOU ARE A US SHAREHOLDER WITH RESPECT TO LTD, LTD AND/OR LTD, SOME OF THE DIVIDEND DISTRIBUTION MAY BE TREATED AS A DISTRIBUTION OF PREVIOUSLY TAXED EARNINGS AND PROFITS UNDER SECTION 959. CURRENT YEAR IRC SECTION 951A ("GILTI") INFORMATION HAS BEEN PROVIDED ON A SEPARATE FOOTNOTE.

BOX 13W - PORTFOLIO DEDUCTIONS - OTHER (FORMERLY DEDUCTIBLE UNDER SEC 67 SUBJECT TO 2% FLOOR)

MANAGEMENT FEES	(722,080)
OTHER EXPENSES	(24,393)
	(746,473)

BOX 20AH - OTHER INFORMATION - SECTION 1061

SECTION 1061 PROVIDES THAT ALL OR A PORTION OF THE NET LONG-TERM CAPITAL GAIN OF A TAXPAYER FROM ASSETS HELD THREE YEARS OR LESS THAT IS ATTRIBUTABLE TO ONE OR MORE APPLICABLE PARTNERSHIP INTERESTS IS SUBJECT TO POTENTIAL RECHARACTERIZATION AS SHORT-TERM CAPITAL GAIN.

THE AMOUNT OF NET LONG-TERM CAPITAL GAIN (LOSS) REPORTED IN BOX 9A AND/OR BOX 11 CODE I FROM ASSETS HELD FOR THREE YEARS OR LESS IS: 0

PLEASE CONSULT YOUR TAX ADVISOR FOR THE PROPER TREATMENT OF THESE ITEMS ON YOUR TAX RETURN.

TO THE BEST OF THE GENERAL PARTNER'S KNOWLEDGE AND BELIEF:

ITEM L - PARTNER CAPITAL ACCOUNT ANALYSIS

ITEM L OF THE PARTNER'S SCHEDULE K-1 IS KEPT ON THE GAAP BASIS.

PART III, BOX 13 OTHER DEDUCTIONS, CODE W - OTHER DEDUCTIONS

FOR INDIVIDUAL TAXPAYERS, CERTAIN IRC SEC. 212 PORTFOLIO DEDUCTIONS WERE PREVIOUSLY DEDUCTIBLE, SUBJECT TO THE 2% ADJUSTED GROSS INCOME FLOOR, UNDER IRC SEC. 67. HOWEVER, THE DEDUCTIBILITY OF THESE ITEMIZED DEDUCTIONS HAS BEEN SUSPENDED PURSUANT TO IRC SEC. 67(G) FOR ANY TAXABLE YEAR BEGINNING AFTER DECEMBER 31, 2017 AND BEFORE JANUARY 1, 2026. FOR TAXPAYERS OTHER THAN INDIVIDUALS, THE DEDUCTIBILITY OF THESE AMOUNTS REMAINS UNCHANGED. YOUR SHARE OF THESE DEDUCTIONS IS REPORTED IN BOX 13 CODE W AS "PORTFOLIO DEDUCTIONS." PLEASE CONSULT YOUR TAX ADVISOR AS TO THE TREATMENT OF THESE EXPENSES ON YOUR TAX RETURN.

PART III, BOX 16 FOREIGN TRANSACTIONS, CODE A - COUNTRY CODE:

FOREIGN COUNTRY CODE OC REFERS TO "VARIOUS COUNTRIES".

PART III, BOX 20 OTHER INFORMATION, CODES A & B -- INVESTMENT INCOME AND EXPENSES

THE AMOUNT REPORTED IN BOX 20 CODE A INCLUDES INTEREST AND DIVIDENDS (INCLUDING QUALIFIED DIVIDENDS). THE AMOUNT REPORTED IN BOX 20 CODE B INCLUDES THE EXPENSES IN BOX 13 CODE L. AMOUNTS REPORTED IN BOXES 1, 8, 9A, AND 11 SHOULD BE CONSIDERED IN COMPUTING YOUR NET INVESTMENT INCOME. PLEASE CONSULT YOUR TAX ADVISOR

PART III, BOX 20 OTHER INFORMATION, CODE Y - NET INVESTMENT INCOME:

THE PARTNERSHIP HAS TAKEN THE POSITION THAT IT IS ENGAGED AS AN INVESTOR IN SECURITIES AND NOT AS A TRADER IN FINANCIAL INSTRUMENTS OR COMMODITIES. UNLESS OTHERWISE INDICATED (FOR EXAMPLE, ITEMS TAKEN INTO CONSIDERATION FOR SELF-EMPLOYMENT TAX PURPOSES), THE AMOUNTS REPORTED ON YOUR SCHEDULE K-1 ARE SUBJECT TO IRC SECTION 1411 AND SHOULD BE CONSIDERED IN COMPUTING YOUR NET INVESTMENT INCOME TAX. DEDUCTIONS REPORTED ON YOUR SCHEDULE K-1 MAY BE SUBJECT TO CERTAIN LIMITATIONS IN COMPUTING YOUR NET INVESTMENT INCOME TAX.

PART III, BOX 20 OTHER INFORMATION, CODE Z - SECTION 199A INCOME:

THE PARTNERSHIP HAS TAKEN THE POSITION THAT IT IS AS AN INVESTOR IN SECURITIES AND THEREFORE IS NOT IN A TRADE OR BUSINESS UNDER SECTION 162. AS A RESULT, PURSUANT TO SECTION 199A AND THE REGULATIONS THEREUNDER, THE PARTNERSHIP DOES NOT HAVE QUALIFIED BUSINESS INCOME. THE PARTNERSHIP DOES NOT HAVE W-2 WAGES NOR QUALIFIED PROPERTY. PLEASE CONSULT YOUR TAX ADVISOR.

UNRELATED BUSINESS TAXABLE INCOME (UBTI)

THE UBTI REPORTED ON LINE 20V, REPRESENTS INCOME/(LOSS) FROM UNDERLYING PARTNERSHIPS ATTRIBUTABLE TO AN UNRELATED TRADE OR BUSINESS.

EFFECTIVELY CONNECTED INCOME (ECI)

THE INCOME/(LOSS) REPORTED ON LINE 20V OF SCHEDULE K-1, REPRESENTS INCOME/(LOSS) THAT IS EFFECTIVELY CONNECTED WITH A TRADE OR BUSINESS WITHIN THE UNITED STATES.

LIMITATION ON PASSIVE ACTIVITY LOSSES UNDER IRC SEC. 469

THE INCOME/(LOSS) REPORTED ON LINE 1 OF SCHEDULE K-1, IF ANY, REPRESENTS INCOME/(LOSS) FROM UNDERLYING PARTNERSHIPS ATTRIBUTABLE TO PASSIVE ACTIVITIES.

FOREIGN REPORTING ON U.S. SOURCED INCOME

THE PARTNERSHIP USES A COMBINATION OF THE LAG METHOD AND CURRENT METHOD TO REPORT WITHHOLDING ON FIXED, DETERMINABLE, ANNUAL, PERIODICAL ("FDAP") INCOME. IF APPLICABLE, YOUR FORM 1042-S HAS BEEN PROVIDED SEPARATELY.

THE INTEREST INCOME REPORTED ON LINE 5 OF SCHEDULE K-1, IF ANY, IS CONSIDERED FDAP INCOME AND QUALIFIES FOR THE PORTFOLIO INTEREST EXEMPTION UNDER SECTION 871(H)(2).

THE DIVIDEND INCOME REPORTED ON LINE 6A OF SCHEDULE K-1, IF ANY, IS FOREIGN SOURCED AND IS NOT SUBJECT TO US WITHHOLDING.

THE PARTNERSHIP DID NOT HOLD ANY ASSETS THAT WOULD BE CONSIDERED US REAL PROPERTY INTEREST ("USRPI") UNDER IRC SECTION 897(C).

651117

Schedule K-1 (Form 1065) **2017**

Department of the Treasury
Internal Revenue Service

For calendar year 2017, or tax year beginning ____ ending ____

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Partner's Share of Income, Deductions, Credits, etc.

▶ See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number

B Partnership's name, address, city, state, and ZIP code

C IRS Center where partnership filed return
EFILE

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's identifying number 79

F Partner's name, address, city, state, and ZIP code

G ☐ General partner or LLC member-manager ☒ Limited partner or other LLC member

H ☒ Domestic partner ☐ Foreign partner

I1 What type of entity is this partner? EXEMPT ORG.

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	9.896436 %	NONE %
Loss	9.896436 %	14.696970 %
Capital	9.896436 %	9.779933 %

K Partner's share of liabilities at year end:

Nonrecourse . . . . . $ 773,730.
Qualified nonrecourse financing . . $
Recourse . . . . . $

L Partner's capital account analysis:

Beginning capital account . . . . . $ 16,851,843.
Capital contributed during the year . $ 9,389,594.
Current year increase (decrease) . . $ -118,396.
Withdrawals & distributions . . . . $ (4,543,194.)
Ending capital account . . . . . $ 21,579,847.

☐ Tax basis ☒ GAAP ☐ Section 704(b) book
☐ Other (explain)

M Did the partner contribute property with a built-in gain or loss?
☐ Yes ☒ No
If "Yes," attach statement (see instructions)

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss) -4,497.	15	Credits
2	Net rental real estate income (loss)		
3	Other net rental income (loss)	16 A	Foreign transactions OC
4	Guaranteed payments	B	1,756,384.
5	Interest income 1,461,720.	D	1,756,384.
6a	Ordinary dividends	E	9,362.
6b	Qualified dividends	G	465.
7	Royalties	I	273,199.
8	Net short-term capital gain (loss) -79,404.	J	6,947.
9a	Net long-term capital gain (loss) -2,503,501.	17 A	Alternative minimum tax (AMT) items 350.
9b	Collectibles (28%) gain (loss)		
9c	Unrecaptured section 1250 gain		
10	Net section 1231 gain (loss)	18	Tax-exempt income and nondeductible expenses
11 A*	Other income (loss) 31,777.	B	11,650.
F*	STMT	C*	339,342.
		19	Distributions
12	Section 179 deduction	A	4,543,194.
13 A*	Other deductions 28.	20	Other information
K*	266,252.	A	1,493,497.
W*	STMT	B	266,252.
14	Self-employment earnings (loss)	V	-6,127.

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see Instructions for Form 1065. www.irs.gov/Form1065

This list identifies the codes used on Schedule K-1 for all partners and provides summarized reporting information for partners who file Form 1040. For detailed reporting and filing information, see the separate Partner's Instructions for Schedule K-1 and the instructions for your income tax return.

	Report on
1. Ordinary business income (loss). Determine whether the income (loss) is passive or nonpassive and enter on your return as follows.	
Passive loss	See the Partner's Instructions
Passive income	Schedule E, line 28, column (g)
Nonpassive loss	See the Partner's Instructions
Nonpassive income	Schedule E, line 28, column (j)
2. Net rental real estate income (loss)	See the Partner's Instructions
3. Other net rental income (loss)	
Net income	Schedule E, line 28, column (g)
Net loss	See the Partner's Instructions
4. Guaranteed payments	Schedule E, line 28, column (j)
5. Interest income	Form 1040, line 8a
6a. Ordinary dividends	Form 1040, line 9a
6b. Qualified dividends	Form 1040, line 9b
7. Royalties	Schedule E, line 4
8. Net short-term capital gain (loss)	Schedule D, line 5
9a. Net long-term capital gain (loss)	Schedule D, line 12
9b. Collectibles (28%) gain (loss)	28% Rate Gain Worksheet, line 4 (Schedule D instructions)
9c. Unrecaptured section 1250 gain	See the Partner's Instructions
10. Net section 1231 gain (loss)	See the Partner's Instructions
11. Other income (loss)	
Code	
A Other portfolio income (loss)	See the Partner's Instructions
B Involuntary conversions	See the Partner's Instructions
C Sec. 1256 contracts & straddles	Form 6781, line 1
D Mining exploration costs recapture	See Pub. 535
E Cancellation of debt	Form 1040, line 21 or Form 982
F Other income (loss)	See the Partner's Instructions
12. Section 179 deduction	See the Partner's Instructions
13. Other deductions	
A Cash contributions (50%)	See the Partner's Instructions
B Cash contributions (30%)	See the Partner's Instructions
C Noncash contributions (50%)	See the Partner's Instructions
D Noncash contributions (30%)	See the Partner's Instructions
E Capital gain property to a 50% organization (30%)	See the Partner's Instructions
F Capital gain property (20%)	See the Partner's Instructions
G Contributions (100%)	See the Partner's Instructions
H Investment interest expense	Form 4952, line 1
I Deductions - royalty income	Schedule E, line 19
J Section 59(e)(2) expenditures	See the Partner's Instructions
K Deductions - portfolio (2% floor)	Schedule A, line 23
L Deductions - portfolio (other)	Schedule A, line 28
M Amounts paid for medical insurance	Schedule A, line 1 or Form 1040, line 29
N Educational assistance benefits	See the Partner's Instructions
O Dependent care benefits	Form 2441, line 12
P Preproductive period expenses	See the Partner's Instructions
Q Commercial revitalization deduction from rental real estate activities	See Form 8582 instructions
R Pensions and IRAs	See the Partner's Instructions
S Reforestation expense deduction	See the Partner's Instructions
T Domestic production activities information	See Form 8903 instructions
U Qualified production activities income	Form 8903, line 7b
V Employer's Form W-2 wages	Form 8903, line 17
W Other deductions	See the Partner's Instructions
14. Self-employment earnings (loss)	

Note: If you have a section 179 deduction or any partner-level deductions, see the Partner's Instructions before completing Schedule SE.

A Net earnings (loss) from self-employment	Schedule SE, Section A or B
B Gross farming or fishing income	See the Partner's Instructions
C Gross non-farm income	See the Partner's Instructions
15. Credits	
A Low-income housing credit (section 42(j)(5)) from pre-2008 buildings	See the Partner's Instructions
B Low-income housing credit (other) from pre-2008 buildings	See the Partner's Instructions
C Low-income housing credit (section 42(j)(5)) from post-2007 buildings	See the Partner's Instructions
D Low-income housing credit (other) from post-2007 buildings	See the Partner's Instructions
E Qualified rehabilitation expenditures (rental real estate)	See the Partner's Instructions
F Other rental real estate credits	See the Partner's Instructions
G Other rental credits	See the Partner's Instructions
H Undistributed capital gains credit	Form 1040, line 73; check box a
I Biofuel producer credit	See the Partner's Instructions
J Work opportunity credit	See the Partner's Instructions
K Disabled access credit	See the Partner's Instructions
L Empowerment zone employment credit	See the Partner's Instructions
M Credit for increasing research activities	See the Partner's Instructions
N Credit for employer social security and Medicare taxes	See the Partner's Instructions
O Backup withholding	See the Partner's Instructions
P Other credits	See the Partner's Instructions
16. Foreign transactions	
A Name of country or U.S. possession	Form 1116, Part I
B Gross income from all sources	Form 1116, Part I
C Gross income sourced at partner level	Form 1116, Part I
Foreign gross income sourced at partnership level	
D Passive category	Form 1116, Part I
E General category	Form 1116, Part I
F Other	Form 1116, Part I
Deductions allocated and apportioned at partner level	
G Interest expense	Form 1116, Part I
H Other	Form 1116, Part I
Deductions allocated and apportioned at partnership level to foreign source income	
I Passive category	Form 1116, Part I
J General category	Form 1116, Part I
K Other	Form 1116, Part I
Other information	
L Total foreign taxes paid	Form 1116, Part II
M Total foreign taxes accrued	Form 1116, Part II
N Reduction in taxes available for credit	Form 1116, line 12
O Foreign trading gross receipts	Form 8873
P Extraterritorial income exclusion	Form 8873
Q Other foreign transactions	See the Partner's Instructions
17. Alternative minimum tax (AMT) items	
A Post-1986 depreciation adjustment	See the Partner's Instructions and the Instructions for Form 6251
B Adjusted gain or loss	See the Partner's Instructions and the Instructions for Form 6251
C Depletion (other than oil & gas)	See the Partner's Instructions and the Instructions for Form 6251
D Oil, gas, & geothermal - gross income	See the Partner's Instructions and the Instructions for Form 6251
E Oil, gas, & geothermal - deductions	See the Partner's Instructions and the Instructions for Form 6251
F Other AMT items	See the Partner's Instructions and the Instructions for Form 6251
18. Tax-exempt income and nondeductible expenses	
A Tax-exempt interest income	Form 1040, line 8b
B Other tax-exempt income	See the Partner's Instructions
C Nondeductible expenses	See the Partner's Instructions
19. Distributions	
A Cash and marketable securities	See the Partner's Instructions
B Distribution subject to section 737	See the Partner's Instructions
C Other property	See the Partner's Instructions
20. Other information	
A Investment income	Form 4952, line 4a
B Investment expenses	Form 4952, line 5
C Fuel tax credit information	Form 4136
D Qualified rehabilitation expenditures (other than rental real estate)	See the Partner's Instructions
E Basis of energy property	See the Partner's Instructions
F Recapture of low-income housing credit (section 42(j)(5))	Form 8611, line 8
G Recapture of low-income housing credit (other)	Form 8611, line 8
H Recapture of investment credit	See Form 4255
I Recapture of other credits	See the Partner's Instructions
J Look-back interest - completed long-term contracts	See Form 8697
K Look-back interest - income forecast method	See Form 8866
L Dispositions of property with section 179 deductions	See the Partner's Instructions
M Recapture of section 179 deduction	See the Partner's Instructions
N Interest expense for corporate partners	See the Partner's Instructions
O Section 453(l)(3) information	See the Partner's Instructions
P Section 453A(c) information	See the Partner's Instructions
Q Section 1260(b) information	See the Partner's Instructions
R Interest allocable to production expenditures	See the Partner's Instructions
S CCF nonqualified withdrawals	See the Partner's Instructions
T Depletion information - oil and gas	See the Partner's Instructions
U Reserved	See the Partner's Instructions
V Unrelated business taxable income	See the Partner's Instructions
W Precontribution gain (loss)	See the Partner's Instructions
X Section 108(i) information	See the Partner's Instructions
Y Net investment income	See the Partner's Instructions
Z Other information	See the Partner's Instructions

SCH K-1 SUPPORTING SCHEDULES

ITEM L - CAPITAL CONTRIBUTIONS

CASH CONTRIBUTIONS	9,389,594.
TOTAL CAPITAL CONTRIBUTIONS	9,389,594.

ITEM L - RECONCILIATION OF INCOME

INCOME (LOSS) FROM SCH. K-1, LINES 1 - 11	-1,084,543.
LESS: DEDUCTIONS FROM SCH. K-1, LINES 12, 13, 16L, AND 16M	273,227.
TOTAL INCOME PER SCHEDULE K-1	-1,357,770.
LESS: EXPENSES RECORDED ON BOOKS, NOT INCLUDED ON SCH. K-1:	
NONDEDUCTIBLE EXPENSES	339,342.
PLUS: INCOME RECORDED ON BOOKS, NOT INCL. ON SCH. K-1:	
TAX-EXEMPT INTEREST	11,650.
UNREALIZED GAIN/(LOSS) AND OTHER BOOK TO TAX DIFFERENCES	1,567,066.
TOTAL INCOME PER ITEM L, CURRENT YEAR INCR(DECR)	-118,396.

ITEM L - WITHDRAWALS AND DISTRIBUTIONS

CASH DISTRIBUTIONS	4,543,194.
TOTAL WITHDRAWALS AND DISTRIBUTIONS	4,543,194.

LINE 11 - OTHER INCOME(LOSS)

A OTHER PORTFOLIO INCOME(LOSS)

SECTION 988 INCOME/(LOSS)	-116.
OTHER INCOME/(LOSS)	31,893.
TOTAL BOX A	31,777.

F OTHER INCOME(LOSS)

OTHER MISCELLANEOUS INCOME	
SEC 965(A) INCLUSION - SEE ATTACHED STMT	6,721.
FROM PASS-THROUGH ENTITIES	2,641.
TOTAL BOX F	9,362.

SCH K-1 SUPPORTING SCHEDULES

LINE 13 - OTHER DEDUCTIONS

A CASH CONTRIBUTIONS (50%)

FROM TRADE\BUSINESS	28.
TOTAL BOX A	28.

K DEDUCTIONS - PORTFOLIO (2% FLOOR)

MANAGEMENT FEES	131,803.
PROFESSIONAL FEES	70,120.
OTHER EXPENSES	64,329.
TOTAL BOX K	266,252.

W OTHER DEDUCTIONS

OTHER DEDUCTIONS INCLUDED IN ITEM L, CURRENT YEAR INCREASE (DECREASE)

SEC 965(C) DEDUCTION - SEE ATTACHED STMT	5,180.
FROM PASS-THROUGH ENTITIES	1,767.
TOTAL BOX W	6,947.

LINE 18C - NONDEDUCTIBLE EXPENSES

NONDEDUCTIBLE EXPENSES	345.
PLACEMENT FEES	338,997.
TOTAL NONDEDUCTIBLE EXPENSES	339,342.

LINE 20 - OTHER INFORMATION

V UNRELATED BUSINESS TAXABLE INCOME

FROM TRADE\BUSINESS	-6,127.
TOTAL BOX V	-6,127.

SCH K-1 SUPPORTING SCHEDULES

PARTNER FOOTNOTES

BOX 19, CODE A - DISTRIBUTIONS - GAIN OR LOSS ON DISTRIBUTION FROM THE PARTNERSHIP

IF YOU MADE A WITHDRAWAL FROM THE PARTNERSHIP, YOU MAY HAVE A GAIN OR LOSS TO RECOGNIZE OUTSIDE THE PARTNERSHIP IN THE YEAR YOU RECEIVED THE CASH DISTRIBUTION FROM THE PARTNERSHIP. PLEASE NOTE THAT THE WITHDRAWAL SHOWN IN BOX 19 CODE A OF THE K-1 MAY REFLECT DISTRIBUTIONS THAT MAY BE RECEIVED/PAID IN THE FOLLOWING TAX YEAR. PLEASE CONSULT YOUR TAX ADVISOR.

BOX 20, CODE Y - NET INVESTMENT INCOME

UNLESS OTHERWISE NOTED, ALL INCOME AND EXPENSE ITEMS REFLECTED ON THIS K-1 ARE INCOME OR DEDUCTIONS (SUBJECT TO LIMITATION) FOR NET INVESTMENT INCOME TAX PURPOSES (IRC SECTION 1411). PLEASE CONSULT YOUR TAX ADVISOR.

REPATRIATION DISCLOSURE

UNDER THE TAX CUTS AND JOBS ACT OF 2017 (P.L. 115-97) CERTAIN SPECIFIED FOREIGN CORPORATIONS' (SPC) "DEFERRED EARNINGS" ARE REQUIRED TO BE INCLUDED IN INCOME FOR 2017. THE TAX MAY BE DEFERRED BY ELECTION AND REDUCED BY FOREIGN TAX CREDITS DEPENDING ON ELECTIONS AVAILABLE TO YOU. THIS FUND HAS DEFERRED EARNINGS THAT YOU ARE REQUIRED TO REPORT. BASED ON THE IRS RELEASE, "QUESTIONS AND ANSWERS ABOUT REPORTING RELATED TO SECTION 965 ON 2017 TAX RETURNS", QUESTION 9 WE ARE REPORTING TO YOU THE FOLLOWING:

AS OTHER INCOME LINE 11F YOUR SHARE OF THE PARTNERSHIP'S INCLUSION AMOUNT UNDER SECTION 965(A);

AS OTHER DEDUCTION LINE 13W YOUR SHARE OF THE PARTNERSHIP'S DEDUCTION UNDER CODE SECTION 965(C);

AS A FOOTNOTE, INFORMATION NECESSARY FOR 10 PERCENT OWNERS TO MAKE AN ELECTION UNDER INTERNAL REVENUE CODE SECTION 962 TO COMPUTE A DEEMED FOREIGN TAX CREDIT DUE TO THE INCLUSION UNDER 965(A).

THIS IS A COMPLEX AREA - PLEASE CONSULT YOUR TAX ADVISOR ACCORDINGLY.

PARTNER FOOTNOTES NOT INCLUDED IN ITEM L

SECTION 965 SUMMARY

OTHER INCOME - LINE 11 (CODE F) SECTION 965(A) INCLUSION - TREATMENT OF DEFERRED FOREIGN INCOME AS SUBPART F	9,362.
OTHER DEDUCTION - LINE 13D (CODE W) SECTION 965(C) DEDUCTION - APPLICATION OF	

SCH K-1 SUPPORTING SCHEDULES

PARTICIPATION EXEMPTION TO INCLUDED INCOME	11,650.
FOREIGN TRANSACTIONS - LINE 16 (CODE B, E, AND J) THE FOLLOWING AMOUNTS HAVE BEEN INCLUDED WITH RESPECT TO SECTION 965.	
CODE B - SECTION 965(A) INCLUSION	9,362.
CODE E - SECTION 965(A) INCLUSION	9,362.
CODE J - SECTION 965(C) DEDUCTION	11,650.
TAX-EXEMPT INCOME AND NONDEDUCTIBLE EXPENSES - LINE 18B SECTION 965(F)(2) - PORTION OF SECTION 965(A) AMOUNT TREATED AS INCOME EXEMPT FROM TAX FOR PURPOSES OF COMPUTING BASIS	11,650.
OTHER INFORMATION THIS INFORMATION HAS BEEN PROVIDED FOR CORPORATE PARTNERS THAT MAY BENEFIT FROM AN INDIRECT FOREIGN TAX CREDIT UNDER SECTION 902. THE INDIRECT FOREIGN TAX CREDIT AMOUNT IS NET OF ANY DISALLOWED PORTION UNDER SECTION 965(G).	
INDIRECT FOREIGN TAX CREDIT (NET)	1,509.
AGGREGATE FOREIGN CASH POSITION	2,849.
TOTAL DEEMED PAID FOREIGN TAXES ASSOCIATED WITH THE TOTAL AMOUNT REQUIRED TO BE INCLUDED IN INCOME BY REASON OF SECTION 965(A).	5,334.
TOTAL DEEMED PAID FOREIGN TAXES DISALLOWED PURSUANT TO IRC 965(G)(1).	3,825.

THE SECTIONS 965(A) AND 956(C) AMOUNTS SHOULD BE REPORTED SEPARATELY. THE PARTNER HAS A POTENTIAL ABILITY TO MAKE AN ELECTION PURSUANT TO SECTION 965(H) TO PAY THE TAX LIABILITY IN INSTALLMENTS.

THE ABOVE INFORMATION IS PROVIDED IN ORDER TO ASSIST PARTNERS IN SATISFYING U.S. INCOME TAX REPORTING REQUIREMENTS AND DOES NOT CONSTITUTE TAX ADVICE. PLEASE CONSULT YOUR TAX ADVISOR CONCERNING THE OVERALL TAX CONSEQUENCES OF THEIR RESPECTIVE SECTION 965 INCLUSION.

651118

Schedule K-1 (Form 1065)
Department of the Treasury
Internal Revenue Service

2018

For calendar year 2018, or tax year beginning ____ ending ____

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Partner's Share of Income, Deductions, Credits, etc.

▶ See separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number

B Partnership's name, address, city, state, and ZIP code

C IRS Center where partnership filed return
E-FILE

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's identifying number

F Partner's name, address, city, state, and ZIP code

G ☐ General partner or LLC member-manager ☒ Limited partner or other LLC member

H ☒ Domestic partner ☐ Foreign partner

I1 What type of entity is this partner? EXEMPT ORGANIZATION

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

J Partner's share of profit, loss, and capital:

	Beginning	Ending
Profit	FORMULA %	FORMULA %
Loss	FORMULA %	FORMULA %
Capital	24.2321591 %	24.4132911 %

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$
Qualified nonrecourse financing	$	$
Recourse	$ 0.	$ 0.

L Partner's capital account analysis:

Beginning capital account	$ 459,116.
Capital contributed during the year	$ 7,742,358.
Current year increase (decrease)	$ -930,381.
Withdrawals & distributions	$ ( )
Ending capital account	$ 7,271,093.

☐ Tax basis ☐ GAAP ☐ Section 704(b) book
☒ Other (explain) SEE STATEMENT

M Did the partner contribute property with a built-in gain or loss?
☐ Yes ☒ No
If "Yes," attach statement (see instructions)

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	-357,591.	
2	Net rental real estate income (loss)		
3	Other net rental income (loss)		
4	Guaranteed payments		
5	Interest income	4.	
6a	Ordinary dividends		
6b	Qualified dividends		
6c	Dividend equivalents		
7	Royalties		
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss)		
9b	Collectibles (28%) gain (loss)		
9c	Unrecaptured sec 1250 gain		
10	Net section 1231 gain (loss)		
11	Other income (loss)		
12	Section 179 deduction		
13	Other deductions	A	90.
		H	100,068.
		*	STMT
14	Self-employment earnings (loss)		
15	Credits		
16	Foreign transactions		
17	Alternative min tax (AMT) items		
18	Tax-exempt income and nondeductible expenses		
19	Distributions		
20	Other information	A	4.
		B	785,423.
		V	-307,561.
		Z *	-342,374.
		AA *	377,764.
		AB *	387,878.
		AC *	0.
		AD *	0.

*See attached statement for additional information.

For IRS Use Only

SCHEDULE K-1	OTHER DEDUCTIONS, BOX 13	
CODE	DESCRIPTION	AMOUNT
K	EXCESS BUSINESS INTEREST EXPENSE	62,754.
L *	DEDUCTIONS - PORTFOLIO (OTHER)	STMT

* SEE ATTACHED STATEMENT FOR ADDITIONAL INFORMATION.

SCHEDULE K-1	OTHER PORTFOLIO DEDUCTIONS, BOX 13, CODE L	
DESCRIPTION	PARTNER FILING INSTRUCTIONS	AMOUNT
DEDUCTIONS-PORTFOLIO		40,300.
DEDUCTIONS-PORTFOLIO: MGMT FEES		745,123.
TOTAL TO SCHEDULE K-1, BOX 13, CODE L		785,423.

SCHEDULE K-1 SECTION 199A ITEMS, BOX 20
CODES Z THROUGH AD

CODE	DESCRIPTION	AMOUNT
	TRADE OR BUSINESS - LENDING TO SMALL BUSINESS CONCERNS	
Z	SECTION 199A QUALIFIED BUSINESS INCOME *	-112,870.
	* INCLUDED	
	ORDINARY INCOME(LOSS)	-112,870.
AA	SECTION 199A W-2 WAGES	0.
AB	SECTION 199A UNADJUSTED BASIS	0.
AC	SECTION 199A REIT DIVIDENDS	0.
AD	SECTION 199A PTP INCOME	0.
	PASSTHROUGH -	
Z	SECTION 199A QUALIFIED BUSINESS INCOME	-97,011.
AA	SECTION 199A W-2 WAGES	14,077.
AB	SECTION 199A UNADJUSTED BASIS	37,535.
AC	SECTION 199A REIT DIVIDENDS	0.
AD	SECTION 199A PTP INCOME	0.
	PASSTHROUGH - OT GROWTH PARTNERS LLC	
Z	SECTION 199A QUALIFIED BUSINESS INCOME	-160,369.
AA	SECTION 199A W-2 WAGES	78,575.
AB	SECTION 199A UNADJUSTED BASIS	311,014.
AC	SECTION 199A REIT DIVIDENDS	0.
AD	SECTION 199A PTP INCOME	0.
	PASSTHROUGH - TRS HOLDCO LLC	
Z	SECTION 199A QUALIFIED BUSINESS INCOME	27,876.
AA	SECTION 199A W-2 WAGES	285,112.
AB	SECTION 199A UNADJUSTED BASIS	39,329.
AC	SECTION 199A REIT DIVIDENDS	0.
AD	SECTION 199A PTP INCOME	0.

SCH K-1

THE SECTION 199A AMOUNTS TO BE USED IN THE CALCULATION OF QUALIFIED BUSINESS INCOME DEDUCTION ON YOUR 1040/1041 RETURN ARE REPORTED ON LINE 20, UNDER CODES Z, AA, AB, AC AND AD. THE CHARITABLE CONTRIBUTIONS, INVESTMENT INTEREST EXPENSE, DEDUCTIONS - ROYALTY INCOME, SECTION 59(E)(2) EXPENDITURES AND DEDUCTIONS - OTHER PORTFOLIO AMOUNTS ARE NOT INCLUDED IN THE CALCULATION OF THE QUALIFIED BUSINESS INCOME AMOUNT UNDER CODE Z. PLEASE CONSULT YOUR TAX ADVISOR REGARDING THE CALCULATION OF THE QUALIFIED BUSINESS INCOME DEDUCTION, INCLUDING THE POSSIBLE AGGREGATIONS AND LIMITATIONS THAT MAY APPLY AND THE FILING OF THE 1.199A-4(C)(2)(I) ANNUAL DISCLOSURE STATEMENT.

SCHEDULE K-1 CURRENT YEAR INCREASES (DECREASES)

DESCRIPTION	AMOUNT	TOTALS
ORDINARY INCOME (LOSS)	-357,591.	
INTEREST INCOME	4.	
SCHEDULE K-1 INCOME SUBTOTAL		-357,587.
CHARITABLE CONTRIBUTIONS	-90.	
INTEREST EXPENSE ON INVESTMENT DEBTS	-100,068.	
PORTFOLIO DEDUCTIONS	-785,423.	
OTHER DEDUCTIONS	-62,754.	
SCHEDULE K-1 DEDUCTIONS SUBTOTAL		-948,335.
NET INCOME (LOSS) PER SCHEDULE K-1		-1,305,922.
NONDEDUCTIBLES FROM PASSTHROUGH	-3,221.	
ORGANIZATIONAL COSTS	223.	
PASSTHROUGH ENTITIES	375,315.	
SYNDICATION COSTS	3,224.	
OTHER INCREASES OR DECREASES SUBTOTAL		375,541.
TOTAL TO SCHEDULE K-1, ITEM L		-930,381.

SCHEDULE K-1 PARTNER'S CAPITAL METHOD EXPLANATION FOR OTHER METHOD, ITEM L

STATUTORY

This list identifies the codes used on Schedule K-1 for all partners and provides summarized reporting information for partners who file Form 1040. For detailed reporting and filing information, see the separate Partner's Instructions for Schedule K-1 and the instructions for your income tax return.

		Report on
1.	Ordinary business income (loss). Determine whether the income (loss) is passive or nonpassive and enter on your return as follows.	
	Passive loss	See the Partner's Instructions
	Passive income	Schedule E, line 28, column (h)
	Nonpassive loss	See the Partner's Instructions
	Nonpassive income	Schedule E, line 28, column (k)
2.	Net rental real estate income (loss)	See the Partner's Instructions
3.	Other net rental income (loss)	
	Net income	Schedule E, line 28, column (h)
	Net loss	See the Partner's Instructions
4.	Guaranteed payments	Schedule E, line 28, column (k)
5.	Interest income	Form 1040, line 2b
6a.	Ordinary dividends	Form 1040, line 3b
6b.	Qualified dividends	Form 1040, line 3a
6c.	Dividend equivalents	See the Partner's Instructions
7.	Royalties	Schedule E, line 4
8.	Net short-term capital gain (loss)	Schedule D, line 5
9a.	Net long-term capital gain (loss)	Schedule D, line 12
9b.	Collectibles (28%) gain (loss)	28% Rate Gain Worksheet, line 4 (Schedule D Instructions)
9c.	Unrecaptured section 1250 gain	See the Partner's Instructions
10.	Net section 1231 gain (loss)	See the Partner's Instructions
11.	Other income (loss)	
	Code	
	A Other portfolio income (loss)	See the Partner's Instructions
	B Involuntary conversions	See the Partner's Instructions
	C Sec. 1256 contracts & straddles	Form 6781, line 1
	D Mining exploration costs recapture	See Pub. 535
	E Cancellation of debt	Schedule 1 (Form 1040), line 21 or Form 982
	F Section 951A income	See the Partner's Instructions
	G Section 965(a) inclusion	
	H Subpart F income other than sections 951A and 965 inclusion	
	I Other income (loss)	
12.	Section 179 deduction	See the Partner's Instructions
13.	Other deductions	
	A Cash contributions (60%)	See the Partner's Instructions
	B Cash contributions (30%)	
	C Noncash contributions (50%)	
	D Noncash contributions (30%)	
	E Capital gain property to a 50% organization (30%)	
	F Capital gain property (20%)	
	G Contributions (100%)	
	H Investment interest expense	Form 4952, line 1
	I Deductions - royalty income	Schedule E, line 19
	J Section 59(e)(2) expenditures	See the Partner's Instructions
	K Excess business interest expense	See the Partner's Instructions
	L Deductions - portfolio (other)	Schedule A, line 16
	M Amounts paid for medical insurance	Schedule A, line 1 or Schedule 1 (Form 1040), line 29
	N Educational assistance benefits	See the Partner's Instructions
	O Dependent care benefits	Form 2441, line 12
	P Preproductive period expenses	See the Partner's Instructions
	Q Commercial revitalization deduction from rental real estate activities	See Form 8582 Instructions
	R Pensions and IRAs	See the Partner's Instructions
	S Reforestation expense deduction	See the Partner's Instructions
	T through V	Reserved for future use
	W Other deductions	See the Partner's Instructions
	X Section 965(c) deduction	See the Partner's Instructions
14.	Self-employment earnings (loss)	

Note: If you have a section 179 deduction or any partner-level deductions, see the Partner's Instructions before completing Schedule SE.

	A Net earnings (loss) from self-employment	Schedule SE, Section A or B
	B Gross farming or fishing income	See the Partner's Instructions
	C Gross non-farm income	See the Partner's Instructions
15.	Credits	
	A Low-income housing credit (section 42(j)(5)) from pre-2008 buildings	See the Partner's Instructions
	B Low-income housing credit (other) from pre-2008 buildings	
	C Low-income housing credit (section 42(j)(5)) from post-2007 buildings	
	D Low-income housing credit (other) from post-2007 buildings	
	E Qualified rehabilitation expenditures (rental real estate)	
	F Other rental real estate credits	
	G Other rental credits	
	H Undistributed capital gains credit	Schedule 5 (Form 1040), line 74, box a
	I Biofuel producer credit	See the Partner's Instructions
	J Work opportunity credit	See the Partner's Instructions
	K Disabled access credit	
	L Empowerment zone employment credit	
	M Credit for increasing research activities	
	N Credit for employer social security and Medicare taxes	
	O Backup withholding	
	P Other credits	
16.	Foreign transactions	
	A Name of country or U.S. possession	Form 1116, Part I
	B Gross income from all sources	
	C Gross income sourced at partner level	
	Foreign gross income sourced at partnership level	
	D Section 951A category	Form 1116, Part I
	E Foreign branch category	
	F Passive category	
	G General category	
	H Other	
	Deductions allocated and apportioned at partner level	
	I Interest expense	Form 1116, Part I
	J Other	Form 1116, Part I
	Deductions allocated and apportioned at partnership level to foreign source income	
	K Section 951A category	Form 1116, Part I
	L Foreign branch category	
	M Passive category	
	N General category	
	O Other	
	Other information	
	P Total foreign taxes paid	Form 1116, Part II
	Q Total foreign taxes accrued	Form 1116, Part II
	R Reduction in taxes available for credit	Form 1116, line 12
	S Foreign trading gross receipts	Form 8873
	T Extraterritorial income exclusion	Form 8873
	U Section 951A(c)(1)(A) tested income	See the Partner's Instructions
	V Tested foreign income tax	
	W Section 965 information	
	X Other foreign transactions	
17.	Alternative minimum tax (AMT) items	
	A Post-1986 depreciation adjustment	See the Partner's Instructions and the Instructions for Form 6251
	B Adjusted gain or loss	
	C Depletion (other than oil & gas)	
	D Oil, gas, & geothermal - gross income	
	E Oil, gas, & geothermal - deductions	
	F Other AMT items	
18.	Tax-exempt income and nondeductible expenses	
	A Tax-exempt interest income	Form 1040, line 2a
	B Other tax-exempt income	See the Partner's Instructions
	C Nondeductible expenses	See the Partner's Instructions
19.	Distributions	
	A Cash and marketable securities	See the Partner's Instructions
	B Distribution subject to section 737	
	C Other property	
20.	Other information	
	A Investment income	Form 4952, line 4a
	B Investment expenses	Form 4952, line 5
	C Fuel tax credit information	Form 4136
	D Qualified rehabilitation expenditures (other than rental real estate)	See the Partner's Instructions
	E Basis of energy property	See the Partner's Instructions
	F Recapture of low-income housing credit (section 42(j)(5))	Form 8611, line 8
	G Recapture of low-income housing credit (other)	Form 8611, line 8
	H Recapture of investment credit	See Form 4255
	I Recapture of other credits	See the Partner's Instructions
	J Look-back interest - completed long-term contracts	See Form 8697
	K Look-back interest - income forecast method	See Form 8866
	L Dispositions of property with section 179 deductions	See the Partner's Instructions
	M Recapture of section 179 deduction	
	N Interest expense for corporate partners	
	O through Y	
	Z Section 199A income	
	AA Section 199A W-2 wages	
	AB Section 199A unadjusted basis	
	AC Section 199A REIT dividends	
	AD Section 199A PTP income	
	AE Excess taxable income	
	AF Excess business interest income	
	AG Gross receipts for section 59A(e)	
	AH Other information	

Schedule of Activities

For calendar year 2018, or tax year beginning , 2018, and ending , .

Name :

For:

Description of Activity	Activity Number	100% Disposed	Publicly Traded Partnership	Type Code *	Description
	1				LENDING TO SMALL BUSINESS CONCERNS
	2				
	3				

	Activity - 1	Activity - 2	Activity - 3
Ordinary business income (loss)	-112,870.	-112,228.	-160,369.
Net rental real estate income (loss)			
Other net rental income (loss)			
Interest income			
Dividends - Ordinary dividends			
- Qualified dividends			
- Dividend equivalents (1065 only)			
Royalties			
Net short-term capital gain (loss)			
Net long-term capital gain (loss)			
- Collectibles (28%) gain (loss)			
- Unrecaptured Section 1250 gain			
Net section 1231 gain (loss)			
Other portfolio income			
Section 1256 contracts and straddles			
Other income			
Section 179 deduction			
Charitable contributions			36.
Portfolio deductions			
Investment interest expense			
Section 59(e)(2) expenditures			
Excess business interest expense			2,618.
Other deductions			
Net earnings from self-employment			
Gross farming or fishing income			
Gross nonfarm income			
LIH credit - Section 42(j)(5) partnerships			
- Other			
Qualified rehabilitation expenditures related to rental real estate			
Other rental credits			
Credits related to other rental activities			
Recapture of LIH credit - Section 42(j)(5) partnerships			
- Other			
Other credits			
Post-1986 depreciation adjustment			
Adjusted gain or loss			
Portion of adjusted gain/loss allocable to short-term gain/loss			
Portion of adjusted gain/loss allocable to long-term gain/loss			
Portion of adjusted gain/loss allocable to section 1231 gain/loss			
Depletion (other than oil and gas)			
Oil, gas and geothermal properties - gross income			
Oil, gas and geothermal properties - deductions			
Other AMT items			
Investment income			
Investment expenses			
Section 199A - Qualified business income	-112,870.	-97,011.	-160,369.
- Specified service income			
- W-2 wages		14,077.	78,575.
- Unadjusted basis of assets		37,535.	311,014.
- PTP income			

825001 02-22-19 1 - Single Family Residence 2 - Multi-Family Residence 3 - Vacation or Short-Term Rental 4 - Commercial 5 - Land 6 - Royalties 7 - Self-Rental 8 - Other

Schedule of Activities

For calendar year 2018, or tax year beginning , 2018, and ending , .

Name :

For:

Description of Activity	Activity Number	100% Disposed	Publicly Traded Partnership	Type Code *	Description
	4				

	Activity - 4	Activity -	Activity -
Ordinary business income (loss)	27,876.		
Net rental real estate income (loss)			
Other net rental income (loss)			
Interest income	4.		
Dividends - Ordinary dividends			
- Qualified dividends			
- Dividend equivalents (1065 only)			
Royalties			
Net short-term capital gain (loss)			
Net long-term capital gain (loss)			
- Collectibles (28%) gain (loss)			
- Unrecaptured Section 1250 gain			
Net section 1231 gain (loss)			
Other portfolio income			
Section 1256 contracts and straddles			
Other income			
Section 179 deduction			
Charitable contributions	54.		
Portfolio deductions			
Investment interest expense			
Section 59(e)(2) expenditures			
Excess business interest expense	60,136.		
Other deductions			
Net earnings from self-employment			
Gross farming or fishing income			
Gross nonfarm income			
LIH credit - Section 42(j)(5) partnerships			
- Other			
Qualified rehabilitation expenditures related to rental real estate			
Other rental credits			
Credits related to other rental activities			
Recapture of LIH credit - Section 42(j)(5) partnerships			
- Other			
Other credits			
Post-1986 depreciation adjustment			
Adjusted gain or loss			
Portion of adjusted gain/loss allocable to short-term gain/loss			
Portion of adjusted gain/loss allocable to long-term gain/loss			
Portion of adjusted gain/loss allocable to section 1231 gain/loss			
Depletion (other than oil and gas)			
Oil, gas and geothermal properties - gross income			
Oil, gas and geothermal properties - deductions			
Other AMT items			
Investment income	4.		
Investment expenses			
Section 199A - Qualified business income	27,876.		
- Specified service income			
- W-2 wages	285,112.		
- Unadjusted basis of assets	39,329.		
- PTP income			

825001 02-22-19 1 - Single Family Residence 2 - Multi-Family Residence 3 - Vacation or Short-Term Rental 4 - Commercial 5 - Land 6 - Royalties 7 - Self-Rental 8 - Other

Exhibit 4

Conference Center A Catering Example - Dual Use Cost Allocations (Gross Receipts, Time, and Space)

Scenario: In this example, related and unrelated parties pay the same price for each menu option.

Unrelated Catering Revenues

	Revenues
Menu Option A	$350,000.00
Menu Option B	$250,000.00
Menu Option C	$400,000.00
	$1,000,000.00

Related Catering Revenues

	Revenues
Menu Option A	$1,000,000.00
Menu Option B	$550,000.00
Menu Option C	$450,000.00
	$2,000,000.00

Expense Category	Total Amount	Factor	Allocable Deduction	Allocation Factor Explanation
Salaries	$1,500,000.00	35%	$525,000.00	Personnel spend 35% of their time on the unrelated business income activity
Benefits	$150,000.00	35%	$52,500.00	
Payroll Tax Expense	$114,750.00	35%	$40,162.50	
Retirement	$115,500.00	35%	$40,425.00	
Costs of Goods Sold Menu Option A*	$500,000.00	25.9%	$129,629.63	Since related and unrelated parties pay the same price, taking unrelated revenues for each menu option divided by total revenues would produce a factor that would be reasonable to use to calculate cost of goods sold deductions.
Cost of Goods Sold Menu Option B*	$300,000.00	31.3%	$93,750.00	
Cost of Goods Sold Menu Option C*	$400,000.00	47.1%	$188,235.29	
Maintenance	$50,000.00	12.5%	$6,250.00	Outside parties only use 50% of the square feet of Conference Center A during events. Additionally outside parties only used the building 25% of the time it was available for use (50% x 25%).
Utilities	$23,000.00	12.5%	$2,875.00	
Interest	$225,000.00	12.5%	$28,125.00	
Depreciation	$200,000.00	12.5%	$25,000.00	
Total Expenses	**$3,578,250.00**		**$1,131,952.42**	

Net Income	**($131,952)**

Gross Receipts - Allocation Factor

Cost of Goods Sold A - Allocation Rate	350000/1350000=25.9%
Cost of Goods Sold B - Allocation Rate	250000/800000=31.3%
Cost of Goods Sold C - Allocation Rate	400000/850000=47.1%

Conference Center A Catering Example (Modified) - Dual Use Cost Allocations (Activity, Time, and Space)

Scenario: In this example, unrelated parties pay more than related parties for the menu options.

Unrelated Catering Revenues		**Revenues**	**Prices**	**Meals Sold**
	Menu Option A	$350,000.00	Price $20/Meal	Meals Sold: 17,500
	Menu Option B	$250,000.00	Price $25/Meal	Meals Sold: 10,000
	Menu Option C	$400,000.00	Price $25/Meal	Meals Sold: 16,000
		$1,000,000.00		

Related Catering Revenues		**Revenues**	**Prices**	**Meals Sold**
	Menu Option A	$1,000,000.00	Price $10/meal	Meals Sold: 100,000
	Menu Option B	$550,000.00	Price $20/meal	Meals Sold: 27,500
	Menu Option C	$450,000.00	Price $20/meal	Meals Sold: 22,500
		$2,000,000.00		

Expense Category	Total Catering Expenses	Factor	Allocable Deduction	Allocation Factor Explanation
Salaries	$1,500,000.00	35%	$525,000.00	Personnel spend 35% of their time on the unrelated business income activity
Benefits	$150,000.00	35%	$52,500.00	
Payroll Tax Expense	$114,750.00	35%	$40,162.50	
Retirement	$115,500.00	35%	$40,425.00	
Cost of Goods Sold Menu Option A*	$500,000.00	14.9%	$74,500.00	Used meals sold as the expense allocation factor
Cost of Goods Sold Menu Option B*	$300,000.00	26.7%	$80,010.00	
Cost of Goods Sold Menu Option C*	$400,000.00	42.9%	$171,600.00	
Maintenance	$50,000.00	12.5%	$6,250.00	Outside parties only use 50% of the square feet of Conference Center A during events. Additionally outside parties only used the building 25% of the time it was available for use (50% x 25%).
Utilities	$23,000.00	12.5%	$2,875.00	
Interest	$225,000.00	12.5%	$28,125.00	
Depreciation	$200,000.00	12.5%	$25,000.00	
Total Expenses	**$3,578,250.00**		**$1,046,447.50**	

Net Income	**($46,448)**

Meals Sold - Allocation Factor

Cost of Goods Sold A - Allocation Rate	17500/117500=14.9%
Cost of Goods Sold B - Allocation Rate	10000/37500=26.7%
Cost of Goods Sold C - Allocation Rate	16000/38500=42.9%